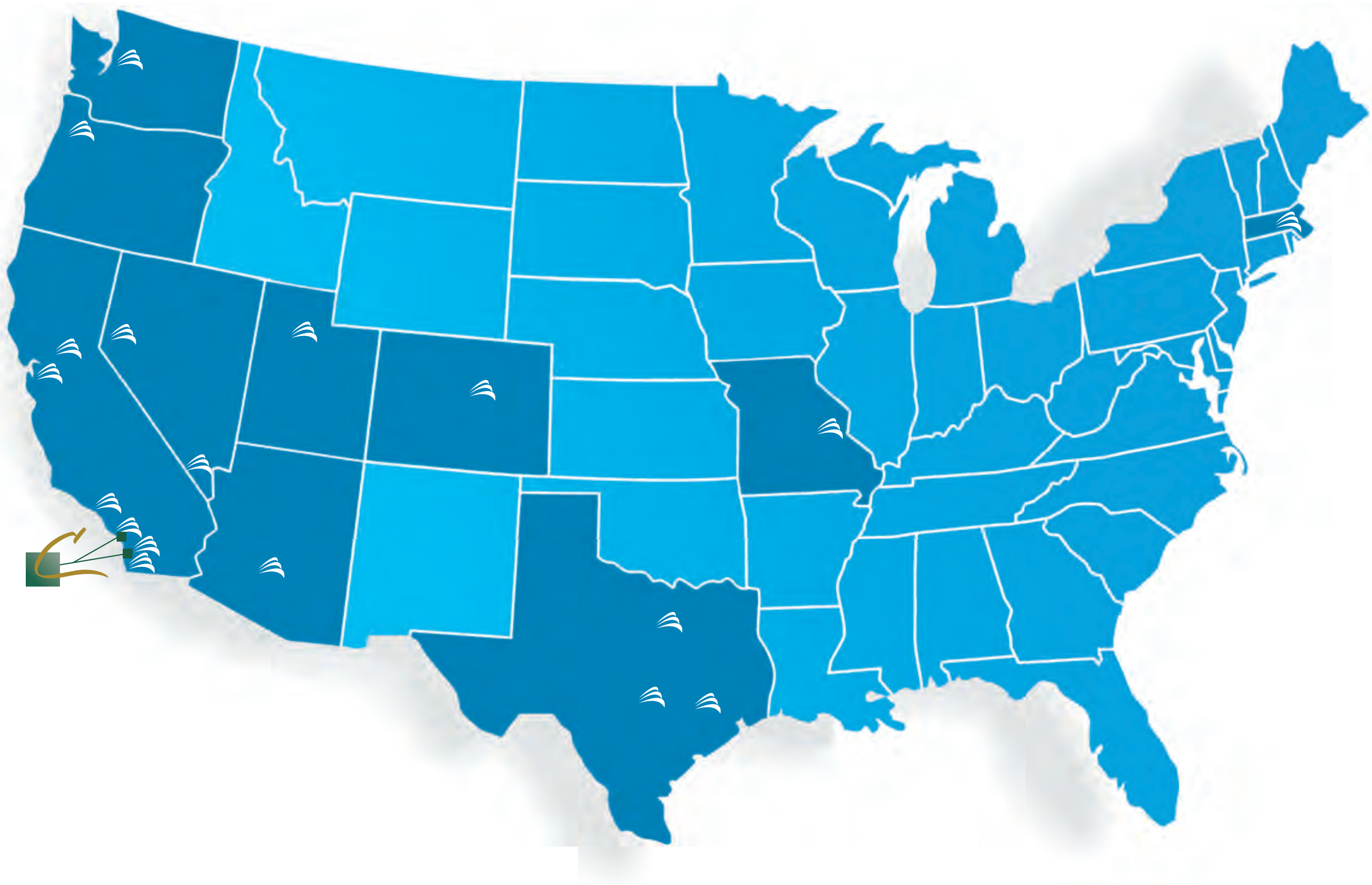
ANNUAL REPORT

Seacoast Commerce Banc Holdings®

2017

LOCATIONS



Corporate Headquarters
11939 Rancho Bernardo Road, Suite 200
San Diego, CA 92128

Branches

Encinitas Branch (Capital Bank)
277 N El Camino Real
Encinitas, CA 92024

National City Branch
22 West 35th Street, Suite 104
National City, CA 91950

San Diego Branch
11939 Rancho Bernardo Road, Suite 200
San Diego, CA 92128

San Juan Capistrano Branch (Capital Bank)
31351 Rancho Viejo Road, Suite 101
San Juan Capistrano, CA 92675

SBA Loan Production Offices

Arizona — Phoenix

California — Encinitas
— Los Angeles
— Orange County
— Sacramento
— San Diego
— San Francisco

Colorado — Denver

Missouri — St. Louis

Nevada — Las Vegas

Oregon — Eugene

Texas — Austin
— Dallas / Ft. Worth
— Houston

Utah — Salt Lake City

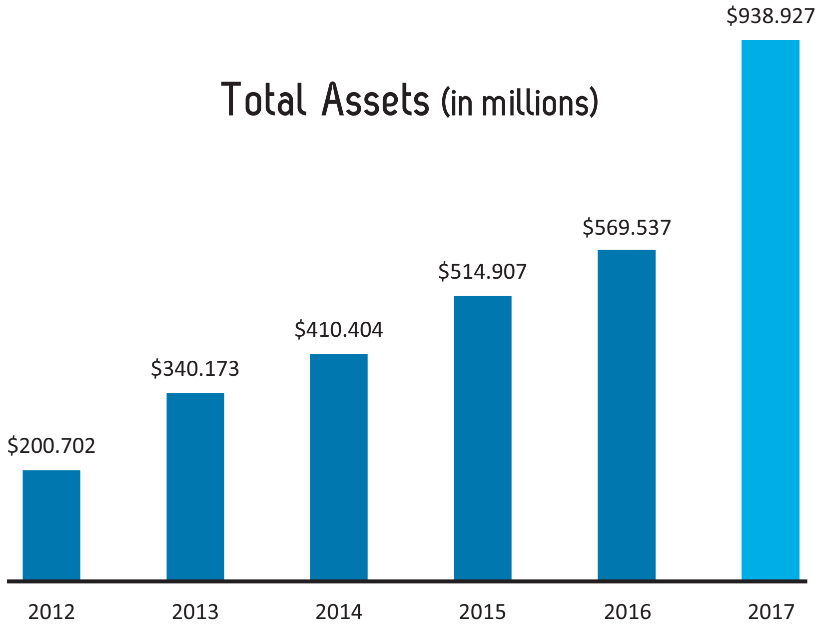
Washington — Seattle

Deposit Production Offices

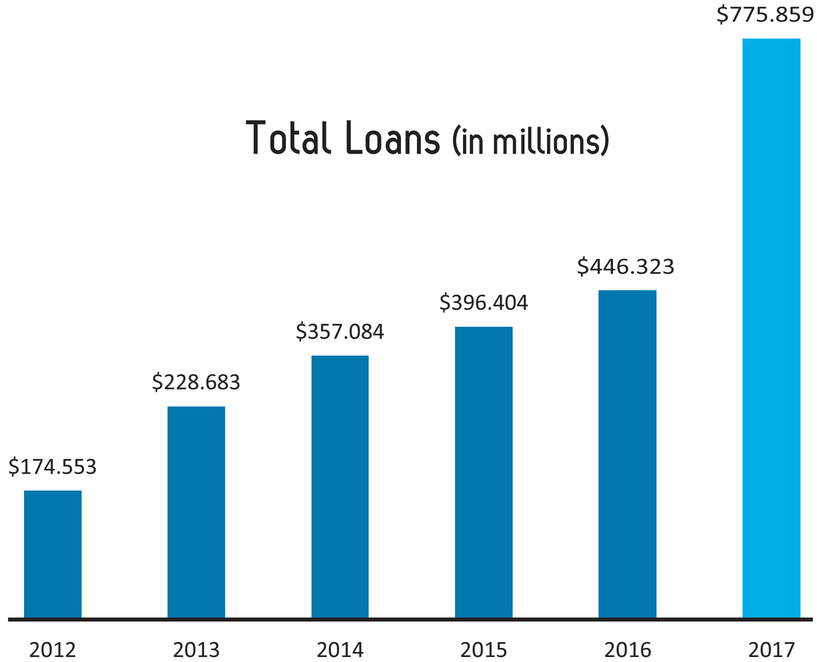
California — San Diego
— Los Angeles

Massachusetts — Boston

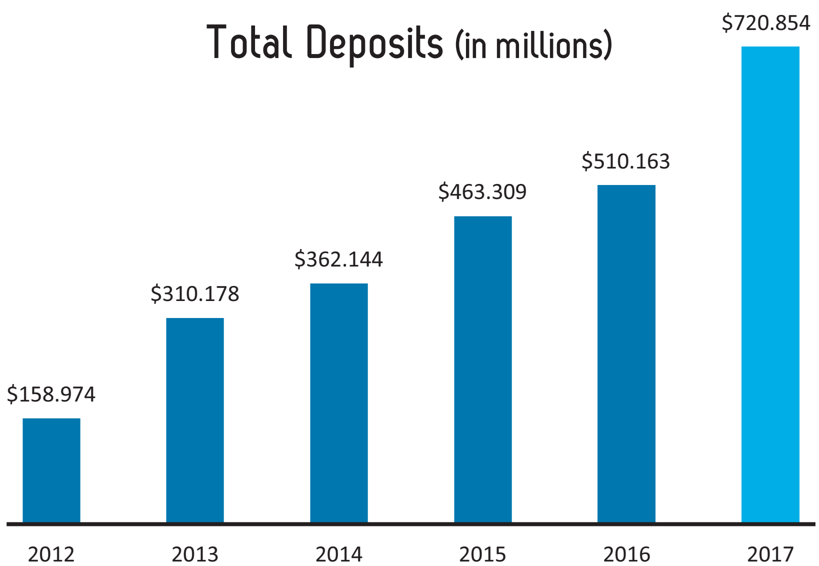
Nevada — Reno



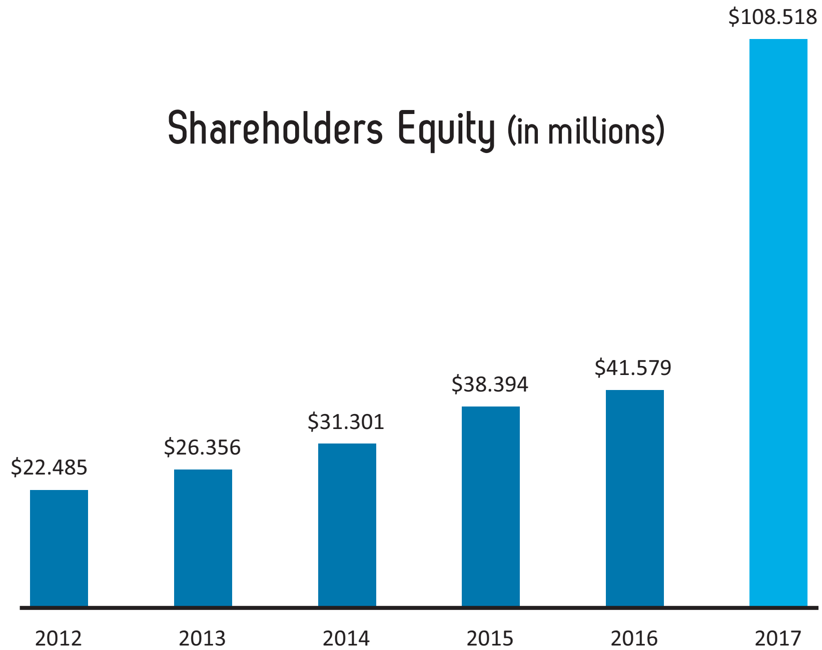
$938.927
Total Assets (in millions)
$569.537
$514.907
$410.404
$340.173
$200.702
2012
2013
2014
2015
2016
2017

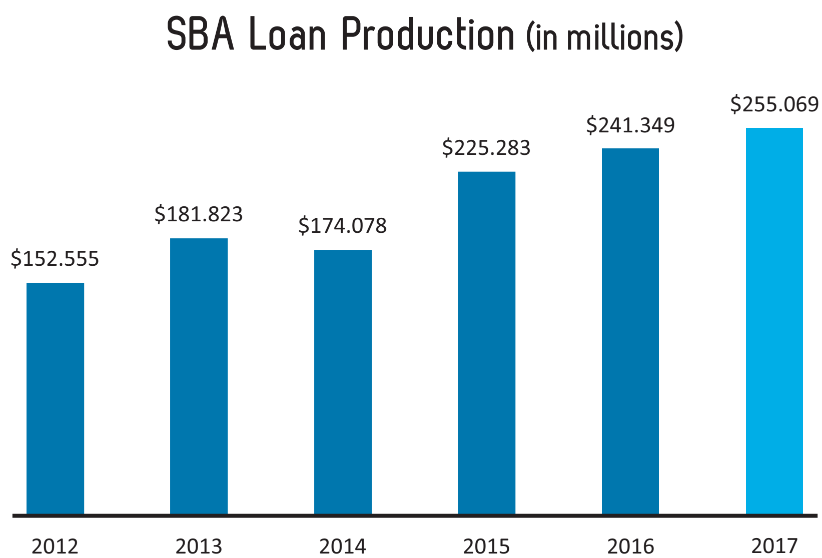


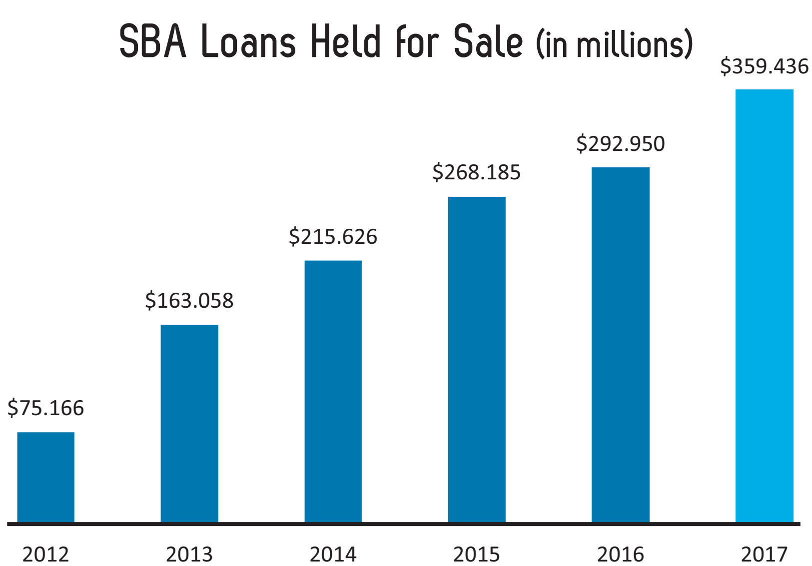
$775.859
Total Loans (in millions)
$446.323
$396.404
$357.084
$228.683
$174.553
2012
2013
2014
2015
2016
2017



Total Deposits (in millions)
$720.854
$510.163
$463.309
$362.144
$310.178
$158.974
2012
2013
2014
2015
2016
2017

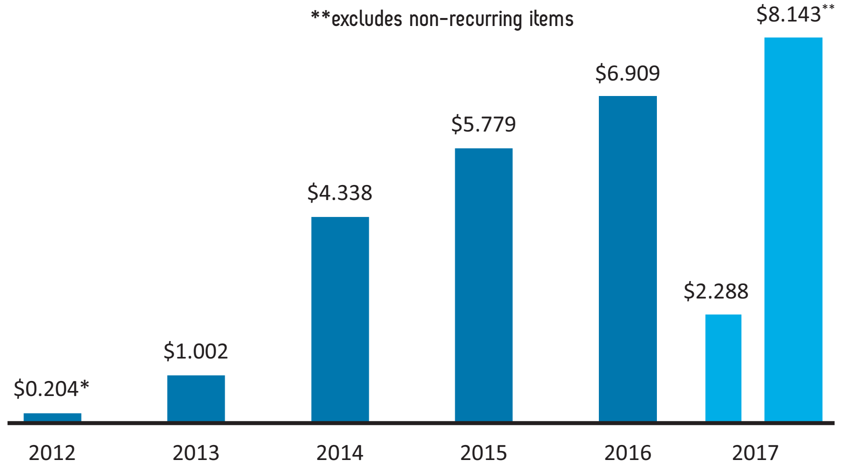

Shareholders Equity (in millions)
$22.485
$26.356
$31.301
$38.394
$41.579
$108.518
2012
2013
2014
2015
2016
2017


SBA Loan Production (in millions)
$152.555
$181.823
$174.078
$225.283
$241.349
$255.069
2012
2013
2014
2015
2016
2017


SBA Loans Held for Sale (in millions)
$75.166
$163.058
$215.626
$268.185
$292.950
$359.436
2012
2013
2014
2015
2016
2017

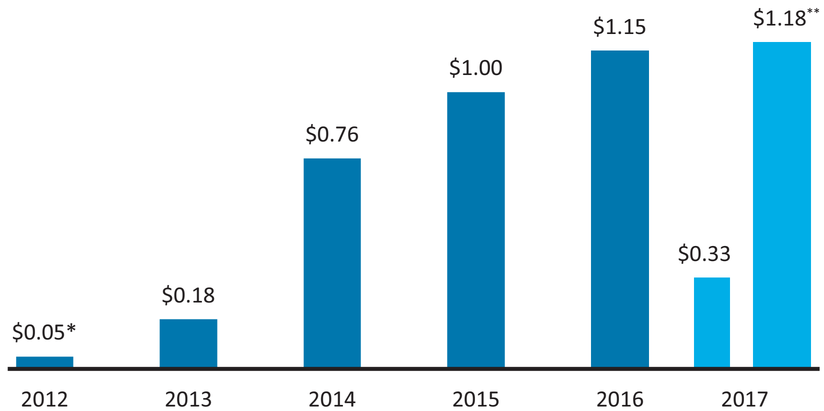
Net Income (in millions)

*excludes 2012 tax benefit
**excludes non-recurring items



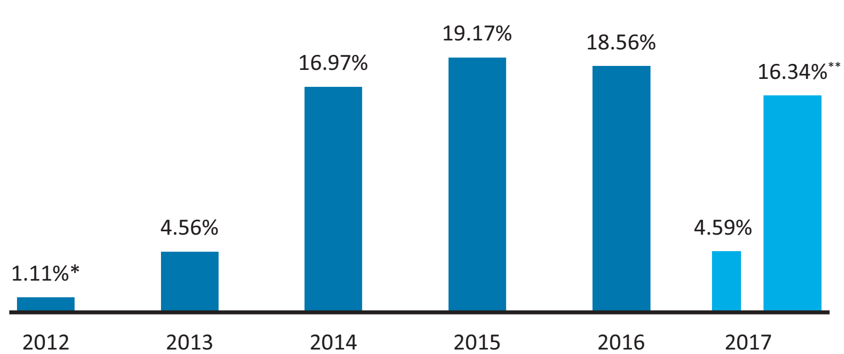
Earnings Per Share

*excludes 2012 tax benefit
**excludes non-recurring items

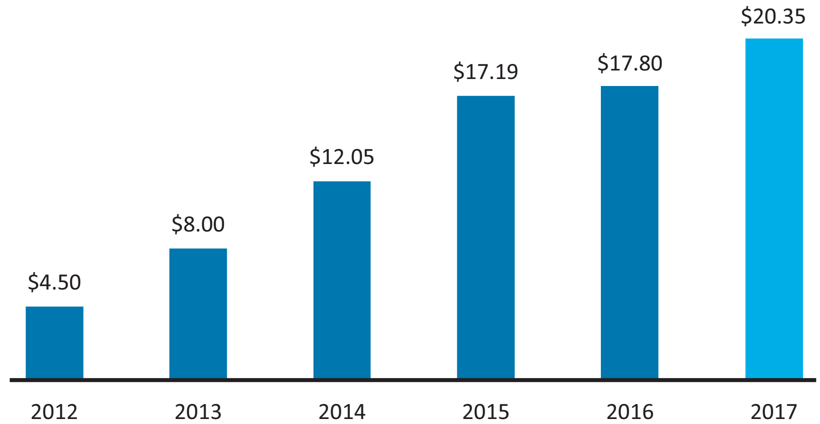


Return on Average Tangible Common Equity

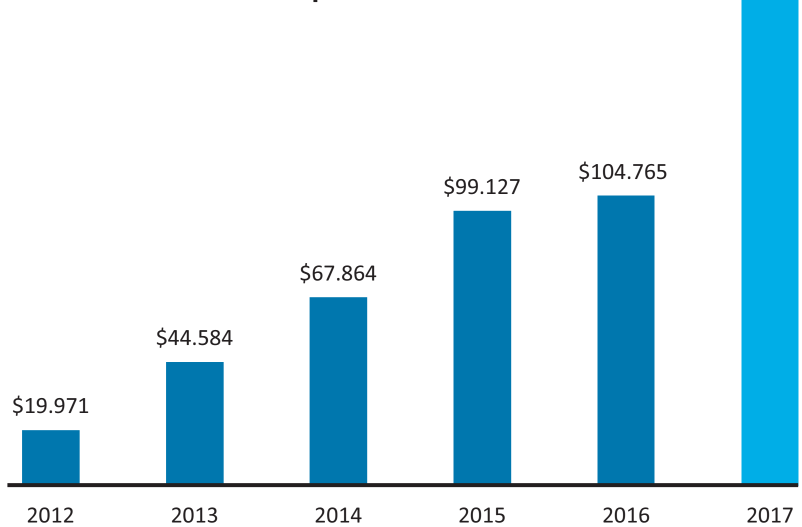
*excludes 2012 tax benefit
**excludes non-recurring items



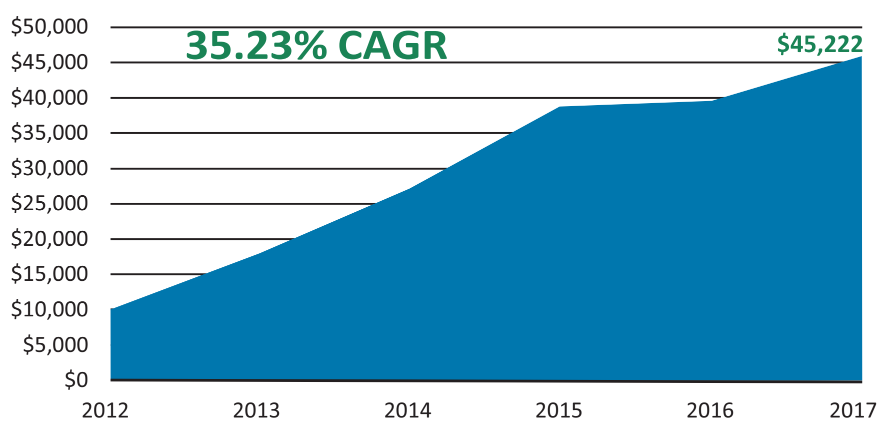
Stock Price



Market Capitalization (in millions)



Value of $10,000 Invested



Seacoast Commerce Banc Holdings®

Dear Fellow Shareholders,

It's hard to believe it has been ten years since we wrote our first "Annual Letter to Shareholders" to you. We started that letter with "2007 marked a year of significant change and challenge for our Bank", and that is partially true for 2017. The Capital Bank acquisition brought significant change to the Bank, but fortunately, no significant challenges. Of course we are now nearly a $1 billion asset bank with 140-some employees, instead of the $60 million asset bank with 18 employees in 2007. Moreover, making decisions to improve the Bank's performance remains the cornerstone of what we did in 2017, just as it did in 2007.

It is not lost on us that no matter how many strategic decisions we make, our success is a direct result of our staff's uncompromising ability to execute in a changing environment. We are not a "serial acquirer" so we don't have a mergers and acquisitions team with the sole focus of completing and integrating acquisitions. While all our staff members have day jobs that require relentless focus, this past year they had the added responsibility of completing and integrating an acquisition. We are very happy to report that they exceeded our expectations by not only completing the Capital Bank acquisition timely, but by integrating the institution's core systems within a month after the closing of the transaction. In their spare time, they completed a record year of loan production, improved on our already excellent credit quality, and recorded our highest annual core income ever. To our invaluable staff...thank you, you are simply the best!

As to the thought about doing an acquisition, given our specialized history, the discussion around the board table is always focused on implementing strategies that deliver superior results to our shareholders. The Capital Bank acquisition was not a transformation or change in our strategy. It was a way for us to expand what we've been doing, namely originating and holding SBA loans, and bringing more non-interest bearing deposits on to our balance sheet. We firmly believe that retaining the guaranteed portions of the SBA loans that we produce adds more shareholder value than any other asset class, especially when funded with low-cost core deposits. The Capital Bank acquisition will allow us to retain an additional $150 million in SBA guaranteed loans over the next three years, as well as allow us to increase our low-cost specialty core deposits more than originally planned. It really was a win-win-win for us and we believe the Capital Bank acquisition aligned very well with our overarching goal: continue to deliver on a strategy that results in superior performance for our shareholders.

While 2017 saw some significant changes in our bank, we continued what we've been doing for the last several years: growing our balance sheet, our loan and deposit production, our SBA loans held for sale, our net core income, and our shareholder value.

As to our earnings, while our reported net income was $2.3 million, it included two significant non-recurring items: one-time merger expenses of $2.0 million (net of tax) related to our acquisition of Capital Bank; and, a non-cash write-down of our deferred tax asset of $3.8 million, required as a result of the recently passed tax reform bill. While we did have to take the deferred tax asset write-down in one lump-sum in the 4th quarter of 2017, we will recoup that write-down through lower income taxes in the future. When both of these non-recurring items are added back to our reported net income, our true comparative net income would be $8.1 million, a 17.9% increase over 2016's net income of $6.9 million, with a comparative earning per share of $1.18, a 2.6% increase over 2016. Our adjusted net income of $8.1 million equates to an adjusted return on average tangible common equity of 16.34%, compared to our regulatory peer group's average returns of 9.69%. We continue to well outperform our peers.

With respect to our balance sheet, 2017 brought good organic growth which was supplemented by our acquisition of Capital Bank. Assets were up 64.9% to just under $1 billion; loans were up 74.6% to $771.4 million; deposits were up 41.3% to $720.9 million; and shareholder equity was up 161.0% to $108.5 million. With the growth in shareholder equity, the banks capital ratios also remain very healthy, far exceeding the highest levels recognized by our regulators, considered "well capitalized". Our Total Risked-Based Capital (TRBC) ratio, one of the most important regulatory ratios that measures a bank's ability to sustain operating losses based on calculated risk in its portfolio, was 15.95%, far exceeding the regulatory "well capitalized" level of 10.50%.

Part of our balance sheet growth was the result of our SBA department's accomplishments in 2017, which included finishing the year as the Small Business Administration's (SBA) 13th largest lender in the nation out of over 3,000 banks in the nation engaged in SBA lending. With $255 million in SBA loans funded, we feel good that we were able to not only provide that capital to small business owners to buy or build buildings for their business, but we helped create or saved close to 8,400 jobs, which is a hallmark of the SBA program. Since inception of our SBA division in 2009 we have originated 1,730 loans and funded over $1.45 billion, and, aside from what is in our portfolio, we service another $441 million in loans that have been sold and are not shown on our balance sheet.

Looking forward, we are very excited about the addition of two key positions announced late last year, the hiring of national sales managers for both our SBA and deposit production teams, as we look to expand both platforms nationwide. We are committed to having a top, national, SBA lending platform, still solely focused on providing SBA real estate loans to small business owners, with those loans being funded predominately by our national specialty deposit divisions. When coupled with our recently acquired commercial banking platform that Capital Bank brought us, we firmly believe we have an excellent mix of traditional and specialty banking that will allow us to out-perform our peers and continue to provide an exceptional return to our shareholders in a safe and sound manner.

We thank you so very much for your continued support.

Very truly yours,

Allan W. Arendsee
Chairman of the Board

Richard M. Sanborn
President & Chief Executive Officer

This letter may contain some non-GAAP financial analysis provided to supplement information regarding the Bank's performance, and to enhance investors' overall understanding of such financial performance. Certain statements in this letter, including statements regarding the anticipated development and expansion of the Bank's business, and the intent, belief or current expectations of the Bank, its directors or its officers, are "forward-looking" statements (as such term is defined in the Private Securities Litigation Reform Act of 1995). Because such statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by such "forward-looking" statements. These risks and uncertainties include, but are not limited to, risks related to the local and national economy, the Bank's performance and regulatory matters.

SEACOAST COMMERCE BANC HOLDINGS
San Diego, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016

SEACOAST COMMERCE BANC HOLDINGS
San Diego, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016

CONTENTS

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Seacoast Commerce Banc Holdings
San Diego, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Seacoast Commerce Banc Holdings, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Seacoast Commerce Banc Holdings as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Costa Mesa, California
March 2, 2018

SEACOAST COMMERCE BANC HOLDINGS
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

	2017	2016
ASSETS		
Cash and due from banks	$ 5,532,096	$ 2,861,294
Interest-bearing deposits in other banks	71,755,308	84,094,335
Cash and cash equivalents	77,287,404	86,955,629
Investment securities available for sale	6,489,474	3,307,891
Loans held for sale	359,435,619	292,950,330
Loans, net ($1,606,478 and $2,231,727 at fair value as of December 31, 2017 and 2016)	411,915,801	148,864,818
Cash surrender value officer life insurance	12,696,410	12,336,207
Premises and equipment	1,607,239	790,588
Federal Reserve Bank and other restricted stock	6,869,706	4,200,306
Other real estate owned (OREO)	613,380	-
SBA loan servicing assets ($247,576 and $377,977 at fair value as of December 31, 2017 and 2016)	7,865,362	6,893,084
Core Deposit Intangible	2,428,984	-
Goodwill	35,393,645	-
Deferred tax asset	8,506,419	9,194,151
Accrued interest and other assets	7,817,494	4,044,108
Total assets	$ 938,926,937	$ 569,537,112
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest bearing demand	$ 295,694,232	$ 261,618,752
Interest checking, savings and money market accounts	376,898,439	235,711,404
Time deposits $250,000 or less	46,841,741	12,074,862
Time deposits greater than $250,000	1,419,396	757,723
Total deposits	720,853,808	510,162,741
FHLB advances	85,000,000	-
Other borrowed money	14,668,859	9,299,092
Income tax payable	2,019,638	627,860
Accrued interest and other liabilities	7,866,669	7,868,289
Total liabilities	830,408,974	527,957,982
Shareholders' equity		
Preferred stock - 10,000,000 shares authorized; $1,000 par value; no shares issued and outstanding at December 31, 2017 and 2016	-	-
Common stock - 20,000,000 shares authorized; no par value; 9,128,572 and 5,885,670 shares issued and outstanding as of December 31, 2017 and 2016	92,883,347	26,919,963
Additional paid-in capital	4,940,876	3,992,951
Retained earnings	10,730,094	10,658,009
Accumulated other comprehensive income	(36,354)	8,207
Total shareholders' equity	108,517,963	41,579,130
Total liabilities and shareholders' equity	$ 938,926,937	$ 569,537,112

See accompanying notes to consolidated financial statements.

SEACOAST COMMERCE BANC HOLDINGS
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2017 and 2016

	2017	2016
Interest Income		
Interest and fees on loans	$ 34,201,689	$ 23,486,331
Interest on investment securities	436,406	65,724
Other interest and dividend income	941,647	980,624
Total interest income	35,579,742	24,532,679
Interest expense		
Interest on checking, savings and money market accounts	1,249,402	1,041,555
Interest on time deposits	242,415	138,163
Interest on borrowings	650,774	440,187
Total interest expense	2,142,591	1,619,905
Net interest income	33,437,151	22,912,774
Provision for loan losses	-	(1,000,000)
Net interest income after provision for loan losses	33,437,151	23,912,774
Noninterest income		
Gain on sale of loans	6,918,643	10,707,075
Loan servicing income	1,846,254	2,009,929
Income from cash surrender value officer life insurance	360,203	310,567
Change in fair value of assets measured at fair value	(119,475)	(158,777)
Service charges, fees and other income	440,387	252,810
Gain (Loss) on sale of OREO	231,882	-
Loss on disposal of premises and equipment	-	(664)
Total non-interest income	9,677,894	13,120,940
Noninterest expense		
Salaries and employee benefits	17,636,565	15,737,697
Occupancy and equipment expenses	1,483,508	1,207,424
Other expenses	13,558,478	9,205,959
Total noninterest expense	32,678,551	26,151,080
Income before income taxes	10,436,494	10,882,634
Income tax expense	8,148,013	3,973,490
Net income	$ 2,288,481	$ 6,909,144
Net income per share - basic	$ 0.33	$ 1.15
Net income per share - diluted	$ 0.31	$ 1.08

See accompanying notes to consolidated financial statements.

SEACOAST COMMERCE BANC HOLDINGS
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2017 and 2016

	2017	2016
Net income	$ 2,288,481	$ 6,909,144
Other comprehensive income:		
Unrealized gains / losses on securities:		
Unrealized holding gain/(loss) arising during the period	(75,161)	(13,321)
Reclassification adjustment for tax effect included in net income	7,829	-
Tax effect	22,771	6,658
Other comprehensive income	(44,561)	(6,663)
Comprehensive income	$ 2,243,920	$ 6,902,481

See accompanying notes to consolidated financial statements.

SEACOAST COMMERCE BANC HOLDINGS
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
Years ended December 31, 2017 and 2016

	Preferred Stock		Common Stock		Additional	Retained Earnings/	Accumulated Other	
	Number of Shares	Amount	Number of Shares	Amount	Paid-in Capital	(Accumulated Deficit)	Comprehensive Income	Total
Balance, January 1, 2016	4,000	$ 3,999,087	5,766,571	$ 26,570,463	$ 3,133,427	$ 4,676,221	$ 14,870	$ 38,394,068
Net income	-	-	-	-	-	6,909,144	-	6,909,144
Accretion of discount of preferred stock	-	913	-	-	-	(913)	-	-
Redemption of preferred stock	(4,000)	(4,000,000)	-	-	-	-	-	(4,000,000)
Exercise of stock awards	-	-	119,099	349,500	-	-	-	349,500
Dividends declared on preferred stock	-	-	-	-	-	(15,667)	-	(15,667)
Dividends declared on common stock	-	-	-	-	-	(910,776)	-	(910,776)
Stock-based compensation	-	-	-	-	859,524	-	-	859,524
Other comprehensive income	-	-	-	-	-	-	(6,663)	(6,663)
Balance, December 31, 2016	-	-	5,885,670	$ 26,919,963	$ 3,992,951	$ 10,658,009	$ 8,207	$ 41,579,130
Net income	-	-	-	-	-	2,288,481	-	2,288,481
Exercise of stock awards			167,189	479,316	-	-	-	479,316
Dividends declared on common stock			-	-	-	(2,216,396)	-	(2,216,396)
Stock-based compensation			-	-	947,925	-	-	947,925
Issuance of common stock in a business combination			2,535,172	55,520,267	-	-	-	55,520,267
Proceeds from sale of common stock, net of expenses			540,541	9,963,801	-	-	-	9,963,801
Other comprehensive income	-	-	-	-	-	-	(44,561)	(44,561)
Balance, December 31, 2017	-	-	9,128,572	$ 92,883,347	$ 4,940,876	$ 10,730,094	$ (36,354)	$ 108,517,963

See accompanying notes to consolidated financial statements.

SEACOAST COMMERCE BANC HOLDINGS
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Net income	$ 2,288,481	$ 6,909,144
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	279,763	235,915
Amortization of core deposit intangible	107,715	-
Stock-based compensation	947,925	859,524
Excess tax benefit related to share based compensation	(546,563)	(292,331)
Income from cash surrender value officer life insurance	(360,203)	(310,567)
Net decrease in fair value of assets measured at fair value	119,475	158,777
Gain on sale of other real estate owned	(231,882)	-
Gain on sale of loans	(6,918,643)	(10,707,075)
Loss on disposal of premises and equipment	-	664
Provision for loan losses	-	(1,000,000)
Provision (recovery) for losses on unfunded commitments	60,000	(30,495)
Proceeds from sale of SBA loans held for sale	95,810,044	139,472,372
Net cash disbursed on SBA loans originated for sale	(132,423,311)	(132,325,167)
Amortization of net premiums on investment securities	52,020	30,261
Amortization and impairment of servicing assets	1,676,831	1,069,328
Deferred loan premiums and origination costs, net of amortization and accretion of deferred costs, fees, premiums and discounts	(3,962,819)	(3,665,802)
Net accretion of acquisition accounting fair value adjustments	(417,894)	-
Net change in deferred tax asset	(22,496)	(811,670)
Decrease in accrued interest and other assets	625,532	127,534
Increase in income tax payable	2,566,200	627,860
Increase (decrease) in accrued interest and other liabilities	(1,103,335)	1,155,900
Net cash from operating activities	(41,453,160)	1,504,172
Cash flows from investing activities		
Purchase of FHLB, FRB and other restricted stock	(980,150)	(292,750)
Purchase of available for sale securities	(4,742,451)	-
Principal paydowns/maturities of available for sale securities	1,433,686	779,502
Purchase of officer life insurance	-	(4,000,000)
Net funding of loans held for investment	(28,464,067)	(45,302,678)
Cash acquired in business combination	11,597,431	-
Proceeds from sale of OREO	410,135	-
Purchases of premises and equipment	(285,391)	-
Proceeds from sale of premises and equipment	-	68,000
Net cash flows from investing activities	(21,030,807)	(48,747,926)

(Continued)

	2017	2016
Cash flows from financing activities		
(Decrease) increase in demand deposits and savings accounts	(16,151,364)	57,269,902
Net decrease in time deposits	(14,629,383)	(10,415,987)
Net proceeds of FHLB Advances	70,000,000	-
Proceeds from other borrowed money	7,000,000	4,000,000
Repayment of other borrowed money	(1,630,233)	(1,162,386)
Redemption of preferred stock	-	(4,000,000)
Proceeds from sale of common stock, net of expenses	9,963,801	-
Dividends paid on common and preferred stock	(2,216,396)	(926,443)
Proceeds from exercise of stock options	479,316	349,500
Net cash flows from financing activities	52,815,741	45,114,586
Net (decrease) increase in cash and cash equivalents	(9,668,226)	(2,129,168)
Beginning cash and cash equivalents	86,955,629	89,084,797
Ending cash and cash equivalents	$ 77,287,403	$ 86,955,629

	2017	2016
Supplemental cash flow information		
Interest paid	$ 2,109,351	$ 1,624,087
Taxes paid	6,750,284	2,807,862
Transfer of loans to OREO	810,387	-
Loans transferred to held for investment from held for sale	1,724,797	-
Loans transferred to held for sale from held for investment	19,822,430	19,842,447
Net accretion of issue discount on perferred stock	-	913
Change in unrealized gains on available for sale securities net of income taxes recorded in other comprehensive income	$ (44,561)	$ (6,663)

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Seacoast Commerce Banc Holdings (the "Company') was created as a bank holding company in a corporate reorganization that took effect November 30, 2014. Holders of Seacoast Commerce Bank (the "Bank") common stock exchanged those shares for an equal number of common shares of Seacoast Commerce Banc Holdings as of that date, and the Bank became a wholly owned subsidiary of the Company. The Bank formed a wholly owned subsidiary, SCB Assets Inc. to take ownership in and manage certain investments on behalf of the Bank. The Bank formed SCB Properties LLC, a Delaware limited liability company, to take ownership in and manage other real estate owned on behalf of the Bank. The operations of the Company, the Bank and the Bank subsidiaries have been consolidated and material intercompany transactions have been eliminated. Seacoast Commerce Banc Holdings has been organized as a single operating segment and operates four full service branches in San Juan Capistrano, Encinitas, National City and San Diego, California under the name Seacoast Commerce Bank.

The Company's primary source of revenue is through providing loans to customers, who are predominately small and middle market businesses and individuals. The Bank operates under a state charter and provides full banking services. In June 2014, the Bank joined the Federal Reserve System, making the Federal Reserve Bank of San Francisco the Bank's primary federal regulator. As a state member bank, the Bank remains subject to regulation by the California Department of Business Oversight.

The Bank has significant operations in originating, selling and servicing small business loans guaranteed by the Small Business Administration ("SBA") under the 7(a) loan program. These loans are used by borrowers for a variety of purposes. The Bank is regulated as a Small Business Lending Bank and operations are dependent on the ability to remain in compliance with the regulations of the Office of Credit Risk Management ("OCRM"). The Bank is evaluated by OCRM through on-site safety and soundness examinations and off-site portfolio performance monitoring. The SBA Division is located in San Diego, California and operates a network of thirteen loan production offices in California, Arizona, Colorado, Nevada, Oregon, Texas and Washington.

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. The following are descriptions of the more significant policies.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through February 28, 2017 which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported, and the disclosures provided in the financial statements. Actual results could differ from the estimates.

Cash and Cash Equivalents: Cash and cash equivalents include cash, short-term time deposits in other financial institutions, and federal funds sold. Amounts due from financial institutions may, at times, exceed federally insured limits. Restricted reserve balances at the Federal Reserve Bank of San Francisco were $34,636,000 and $19,080,000 at December 31, 2017 and 2016, respectively.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the intent and ability to hold them to maturity. Without the intent and ability to hold to maturity, debt securities are classified as available for sale. Securities classified as available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method. Expected prepayments are included in the level yield calculation for mortgage backed securities. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings. The Company's portfolio of investment securities consists primarily of U.S. Government entity and agency debt securities with no credit risk. The portfolio had no OTTI at and for the periods ending December 31, 2017 and 2016.

Revenue Recognition: The Company's SBA operation originates loans to customers under the SBA 7(a) program that generally provides for guarantees of 75% to 85% of each loan, subject to a maximum guaranteed amount. The guaranteed portion of the loan can be sold in an active secondary market of broker/dealers and the unguaranteed portion is retained. The sale of SBA guaranteed loans is controlled by the SBA Secondary Participation Guaranty Agreement ("1086 agreement"). All sales of guaranteed loans are eligible for sales accounting treatment and the Company recognizes the gain on sale at the settlement date.

SBA Lending Activity and Adoption of Fair Value Option: The Company elected to account for SBA 7(a) loans originated in 2010 under a fair value option provided under accounting principles generally accepted in the United States of America. Under the fair value option, the Company measures the loans at fair value at each reporting date and records changes in the fair value in earnings in the period in which the changes occur. When the fair value option is elected, it must be applied to the whole loan, both the guaranteed portion, and the unguaranteed portion. Once the fair value election is made, it is irrevocable and the loan is adjusted to the current fair value on a recurring basis. The guaranteed portions of these loans have been sold and the unguaranteed portions retained remain subject to the fair value accounting treatment. The fair value measurement for the unguaranteed portions is based on the Company's assessment of the discount rates, prepayment speeds and default loss other market participants would use to value the loan. The fair value of these unguaranteed portions is generally discounted, reflecting potential credit loss and the higher effective yield required to compensate for that risk. The net fair value adjustment from the unguaranteed portions is presented in the income statement in the "Change in fair value of assets measured at fair value." The Company did not elect fair value accounting for any new loans originated after 2010.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Gain on Sale of Loans: All sales of SBA guaranteed loans are executed on a servicing retained basis, and the Company retains the rights and obligations to service the loans. The standard sale structure under the 1086 agreement provides for the Company to retain a portion of the cash flow from the interest payment received on the loan. This cash flow is commonly known as a “servicing spread.” SBA regulations require the seller/servicer to keep at least 100 basis points in servicing spread with the sale of a guaranteed loan. The servicing spread is recognized as a “servicing asset” to the extent the spread exceeds “adequate compensation” for the servicing function. Industry practice recognizes adequate compensation for servicing SBA loans as 40 basis points. The fair value of the servicing asset is measured at the discounted present value of the excess servicing spread over the expected life of the related loan using appropriate discount rates and assumptions based on industry statistics for prepayment speeds.

When a loan sale involves the transfer of an interest less than the entire loan, Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (ASC) 860, *Transfers and Servicing,* requires the seller to reallocate the carrying basis between the assets transferred and the assets retained based on the relative fair value of the respective assets as of the date of sale. The maximum gain on sale that can be recognized is the difference between the fair value of the assets sold and the reallocated basis of the assets sold. The Company measures the fair value of the guaranteed portion sold by the cash premium bid by the broker/dealer. The fair values of the servicing asset and the unguaranteed portion retained are based on discounted cash flow calculations as explained above. The limitation on the maximum gain recognition results in a discount recorded on the unguaranteed portion of the loan. The gain on sale recognized in income is the sum of the cash premium on the guaranteed loan, the fair value of the servicing assets recognized, less the discount recorded on the unguaranteed portion retained, and less the net deferred loan origination costs.

The Company can sell participations in unguaranteed loans provided the buyer is an SBA approved lender and the Company retains the minimum interest in the loan required by the SBA. The Company sold participations in unguaranteed SBA loans of $19,822,430 and $19,842,447 in 2017 and 2016, respectively. These sales are made without recourse and are eligible for sale accounting treatment. The sales are subject to the ASC 860 reallocation of basis and in the case of the guaranteed portion of the loan retained, a deferred premium on the unsold guaranteed portion is recorded in the gain on sale. If the guaranteed portion of the loan had been previously sold, the discount recorded with the previous sale was recognized in the calculation of the gain on sale of the unguaranteed participation. The 1086 agreement does not control the sale of unguaranteed portions. The Company retained servicing on these participations at the 40 basis point adequate compensation. No servicing assets are created with the sale of unguaranteed participations.

SBA Servicing Assets: Servicing assets are initially recognized at fair value and that fair value is an integral part of the accounting gain recognized with the sale of SBA guaranteed loans. In 2010 the Company elected the fair value option for SBA 7(a) loans originated, and applied that option to the related servicing assets as well. Under the fair value option method, the Company measures servicing rights at fair value at each reporting date and records changes in the fair value of servicing assets in earnings in the period in which the changes occur. The fair value change is presented in the consolidated statements of income in the “Change in fair value of assets measured at fair value.” The fair values of servicing assets can fluctuate as a result of changes in discount rates and estimated prepayment speeds. The Company did not elect the fair value measurement method for any new servicing assets created after 2010.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SBA Servicing Assets (continued): The Company's servicing assets are divided into two tranches: a tranche for assets created from guaranteed loans sold before 2011, which is accounted for under the fair value measurement method and recorded at fair value on a recurring basis ("Fair Value Tranche"), and a tranche for assets created from guaranteed sales made since then which is tested for impairment on a regular basis and reported at fair value initially and on a nonrecurring basis thereafter ("Impairment Tranche").

Servicing assets accounted for using the amortization and impairment method are initially recorded at fair value and amortized over the expected life of the related loans as a reduction of the servicing income recognized from the servicing spread. The amortized basis in the asset is compared against the fair value of the asset at the balance sheet date. If the carrying amount exceeds the fair value, the asset is considered impaired and is written down to fair value through a valuation allowance on the asset and a charge against earnings. Servicing assets that pertain to loans in nonperforming status are impaired if the absence of cash flow from the loan has eliminated the servicing spread. Should fair value recover in a subsequent quarter, the impairment may be reversed, but only to the extent impairment was originally recognized. These servicing assets cannot be written up above the original fair value when first recorded.

Loan servicing income is recorded as payments are received and processed on the serviced loans. Servicing income totaled $1,846,254 and $2,009,929 for the years ended December 31, 2017 and 2016, respectively. The Bank recorded $34,917 of impairment in 2017, and reversed $5,505 of impairment in 2016. The valuation allowance against the Impairment Tranche was $83,360 at December 31, 2017, and $48,443 at December 31, 2016.

Concentration of Credit Risk: The Company established SBA lending operations in 2009 with an emphasis to support the real estate financing needs of owner/user small businesses. The Company has originated residential real estate, commercial and consumer loans within its service area, but most lending activities since 2009 have been within the SBA product line. The Bank's loan portfolio consists primarily of owner occupied, real estate secured loans. Most of the portfolio is within the state of California; however SBA production offices in Washington, Arizona, Nevada, Colorado, Oregon and Texas have added some geographic diversification to the portfolio. Although the portfolio has significant diversification across industries and classifications of commercial real estate, the Company's loan and collateral portfolios are, to some degree, concentrated in owner/user commercial real estate.

Loans: Loans receivable that management has the intent and ability to hold until maturity or payoff are classified as loans held for investment and reported at their outstanding unpaid principal balances reduced by any charge-offs and net of unamortized deferred fees, discounts or origination costs. Loan origination fees and costs are capitalized and recognized as an adjustment of the yield on the related loan following the interest method. Amortization of deferred loan fees and discounts is discontinued when a loan is placed on nonaccrual status.

Interest income on loans is recognized as earned on a daily accrual basis. The accrual of interest on loans is discontinued when principal or interest is past due 90 days unless the loan is well secured and in the process of collection. Past due status is based on the contractual terms of the loan. Loans may be placed on nonaccrual earlier when, in the opinion of management, the collectability of interest and

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (continued): principal is doubtful. When loans are placed on nonaccrual status, all interest receivable accrued, but not collected, is reversed against interest income in the current period. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Otherwise, cash payments of interest will be applied to principal. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest, based on an assessment of the borrower's financial condition and a recent history of payment performance.

Allowance for Loan Losses: The allowance for loan losses is maintained at a level that is estimated to be sufficient to absorb probable incurred losses on existing loans. The allowance is established by a provision for loan loss charged against earnings. Loan losses are charged against the allowance when management believes no further loan payments will be received and all collateral has been exhausted. Subsequent recoveries, if any, are credited to the allowance. Management estimates the required allowance using past loan loss experience, adjusted for the nature and volume of the portfolio, information about specific borrower situations, estimated collateral values, general economic conditions, and other factors. The evaluation of the allowance is continuous and subjective as estimates are modified with changing conditions. Allocations of the allowance may be made by class of loans and for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is generally measured on a loan by loan basis using either the present value of expected future cash flows discounted at the loans effective interest rate, the loan's observable market price, if available, or the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is recognized following the policy and practice for accrual status.

Loans Held for Sale: Management designates loans as held for sale based on intent. In 2017 and 2016 generally all guaranteed portions of SBA loans meeting salability requirements, or expected to become salable within nine months, are designated as held for sale. Salability requirements include full disbursement of the loan commitment and monthly principal and interest payments are received as agreed. Loans held for sale are carried at the lower of cost or fair value, with fair value estimated on an aggregate basis.

The cost basis of loans held for sale includes capitalized premiums, origination fees and origination costs. Premiums, fees and costs are not accreted and amortized for loans classified held for sale. These premiums, fees and costs are recognized as an adjustment to the gain on sale. No allowance for loan loss is provided for the inventory of loans held for sale.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Transfers of Financial Assets (continued): constrain it from taking advantage of that right) to pledge or exchange the transferred assets and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other Real Estate Owned: Assets acquired through foreclosure or trust deed sale are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Construction costs and durable improvements are capitalized, provided the capitalization does not cause the carrying value to exceed fair value less estimated costs to sell. Operating costs after acquisition are expensed.

Premises and Equipment: Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to ten years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter.

Federal Reserve Bank and Other Restricted Stock: As a member of the Federal Reserve System, the Bank is required to hold a minimum investment in the stock of the Federal Reserve Bank of San Francisco. The Bank is a member of the Federal Home Loan Bank (FHLB) of San Francisco. Members are required to own a certain amount of FHLB stock based on the level of advances taken and other factors. The Bank also holds common and preferred stock issued by Pacific Coast Bankers Bancshares. Other restricted stock represents a minority equity interest in an independent company providing banking related services. Restricted stock investments are accounted for following the cost method and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. See Note 2 for additional information about restricted stock investments.

Cash Surrender Value Officer Life Insurance: The Bank has purchased life insurance policies on certain senior officers. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

In December 2017, the federal congress passed, and the President signed, the Tax Cuts and Jobs Act, reducing the statutory federal corporate tax rate from 35% to 21%, beginning with the 2018 tax year. To state the deferred tax assets and liabilities at the expected tax rate when these temporary differences will be recognized, the Company recorded a charge to income tax expense of $3,811,297 to reduce the net deferred tax asset to the expected future amount at the lower tax rate. See “Adoption of New Accounting Standards” below and Note 8 for further discussion of income taxes.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income: Comprehensive income is presented in a separate statement and consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which is recognized net of the tax effect as a separate component of Shareholders equity.

Earnings Per Share (EPS): Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares and participating securities outstanding during the period. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under any outstanding stock options, warrants and unvested restricted stock awards that are not participating securities. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Stock-Based Compensation: The Company recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period an employee is required to provide services in exchange for the award, generally the vesting period. See Note 14 for additional information on the Company's stock-based compensation plan.

Loan Commitments and Related Financial Instruments: In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit described in Note 13. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Operating Segments: While management monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a company-wide basis. Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated into one reportable operating segment.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or Shareholders equity.

Adoption of New Accounting Standards: In March 2016 the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. This ASU amended existing guidance to simplify the accounting for share-based payment award transactions, including income tax consequences. The amendments require all excess tax benefits or tax deficiencies from the exercise of share-based awards to be recognized through the income statement as income tax expense/benefit. The amendments are effective for public companies for annual periods beginning after December 15, 2016; and annual periods beginning after December 15, 2017 for private companies. Early adoption is permitted and the Company made the election to adopt the amendments in 2016. The Company recognized tax benefits of $546,563 and $292,331 for share-based awards exercised in 2017 and 2016, respectively. See Note 8 for additional information about ASU 2016-09.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards (Continued): In May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718), Scope of Modification Accounting)*. ASU 2017-09 clarifies when changes to the terms and conditions of share-based payment awards must be treated as modifications. Specifically, the new guidance permits companies to make certain changes to awards without accounting for them as modifications. ASU 2017-09 is effective for annual periods beginning after December 31, 2017 and will be applied prospectively to an award modified after the effective date. The Company is currently evaluating the effects of ASU 2017-09 on its financial statements and disclosures.

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to the newly enacted Tax Cuts and Jobs Act corporate income tax rate is required to be included in income from continuing operations. The tax effects of items within accumulated other comprehensive income, referred to as stranded tax effects, do not reflect the appropriate tax rate. ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects.

The amendments in ASU 2018-02 are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company recognized $7,829 as income tax expense in 2017 for the tax effect of unrealized losses on available for sale securities accounted for through other comprehensive income. The Company did not early adopt ASU 2018-02 in 2017 and the reclassification between comprehensive income and retained earnings has not been made. The Company is evaluation the timing of adopting this ASU.

(Continued)

NOTE 2 - INVESTMENT SECURITIES

The carrying amount of available for sale securities and their fair values at December 31, 2017 and 2016 are as follows:

2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities, residential	$ 6,043,101	$ 9,618	$ (67,610)	$ 5,985,109
Corporate securites	508,302	-	(3,937)	504,365
Total available for sale	$ 6,551,403	$ 9,618	$ (71,547)	$ 6,489,474

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities, residential	$ 3,294,658	$ 35,210	$ (21,977)	$ 3,307,891
Total available for sale	$ 3,294,658	$ 35,210	$ (21,977)	$ 3,307,891

The Company had no other-than-temporary impairment recognized in accumulated other comprehensive income for securities available for sale at December 31, 2017 or 2016. The company had no investment securities pledged to secure credit facilities as of December 31, 2017 and December 31, 2016.

The amortized cost and estimated fair value of all investment securities as of December 31, 2017 are presented by contractual maturity below. Residential mortgage-backed securities held are issued by the U.S. Government and its agencies. Mortgage-backed securities are not due at a single maturity as the monthly payments of principal and interest pass through to the investor. Borrowers may prepay the mortgages with or without prepayment penalties. The mortgage-backed securities are classified separately in the maturity schedule.

	December 31, 2017	
	Fair Value	Amortized Cost
Less than one year	$ -	$ -
One to five years	504,365	508,302
Five to ten years	-	-
Beyond ten years	-	-
Mortgage-backed securities, residential	5,985,109	6,043,101
Total	$ 6,489,474	$ 6,551,403

At year-end 2017 and 2016, there were no holdings of securities of any one issuer in an amount greater than 10% of Shareholders equity.

(Continued)

NOTE 2 - INVESTMENT SECURITIES (Continued)

Nonmarketable restricted stock investments at December 31, 2017 and 2016 were as follows:

	2017	2016
Federal Home Loan Bank (FHLB) stock	$ 2,666,800	$ 2,119,000
Federal Reserve Bank of San Francisco stock	3,311,550	1,189,950
Pacific Coast Bankers' Bancshares preferred stock	500,000	500,000
Pacific Coast Bankers' Bancshares common stock	160,000	160,000
Other restricted stock	231,356	231,356
	$ 6,869,706	$ 4,200,306

Nonmarketable restricted stock investments are evaluated for impairment on a regular basis. Impairment is recognized by direct write-down of the cost basis. The Company recognized no impairment on restricted stock in 2017 and 2016.

(Continued)

NOTE 3 - LOANS

The table below presents the main classifications of loans held for investment as of December 31, 2017 and 2016:

	2017	2016
Residential construction	$ 29,689,928	$ -
Commercial real estate	152,516,782	19,598,730
SBA 7(a)	169,697,613	135,555,484
Commercial	37,456,562	2,854,342
Residential real estate	34,083,318	200,462
Consumer loans, primarily unsecured	369,660	583,951
Loans receivable	423,813,863	158,792,969
Deferred loan origination costs, net	2,422,133	2,052,069
Discount on SBA unguaranteed loans	(7,585,783)	(7,385,073)
Discount under fair value option and acquistion accounting, net	(2,226,958)	(87,693)
Allowance for loan losses	(4,507,454)	(4,507,454)
Loans receivable, net	$ 411,915,801	$ 148,864,818

The Company's loan portfolio classified as held for sale as of December 31, 2017 and 2016 is presented below.

	2017	2016
SBA guaranteed 7(a) loans held for sale	$ 349,381,563	$ 284,362,276
Deferred premiums and loan origination costs	10,054,056	8,588,054
SBA guaranteed 7(a) loans held for sale at cost	$ 359,435,619	$ 292,950,330

Serviced loans are not carried in the Company's consolidated balance sheet. At December 31, 2017 and 2016, the Company was servicing $442,311,328 and $386,177,907, respectively, of loans sold to investors.

The Company's portfolio of residential construction loans was acquired in the business combination with Capital Bank discussed in Note 19. These short-term loans are primarily ground-up or extensive remodeling of upscale single family properties that the contractor/developer intends to sell as the source of repayment. This lending activity has inherent risk of delay in the permit, construction, and inspection process as well as economic conditions affecting the contractor/developer ability to sell the finished product.

The Company also does construction lending within the SBA 7(a) program and the ordinary construction loan risks are mitigated by the SBA guarantee. The loans have a twenty-five year term with the construction typically tenant improvements to owner/user commercial real estate over the first year. The Company will classify these guaranteed loans as held for sale when the construction period is expected to be completed within nine months. The Company had no conventional construction and land loans for residential or commercial property originated outside the SBA 7(a) program in portfolio at December 31, 2016.

(Continued)

NOTE 3 - LOANS (Continued)

The Company's commercial real estate classification represents seasoned conventional product and the majority of this portfolio is secured by owner occupied properties. All commercial real estate whether owner or non-owner occupied is subject to valuation risk due to general economic conditions and business cycles. This can adversely impact the performance of the specific business in the property as either owner/user or tenant. Non-owner occupied properties have further valuation risk associated with the general rate of occupancy and the prevailing lease rates.

The portfolio of SBA loans is predominately 7(a) product secured by owner occupied commercial real estate. The guaranteed balances are generally classified as held for sale. The unguaranteed loan balances include $1,606,478 subject to the fair value accounting option. An element of credit loss is inherent in the measurement under the fair value election and accordingly, no allowance for loan loss is maintained for these loans carried at fair value.

Commercial loans whether secured or unsecured support the operations of small businesses and the risk of loss follows the performance of the specific business. Residential real estate loans include permanent mortgage financing and home equity credit lines. These loans have risk associated with the volatility in collateral value. These loans, as well as consumer loans, are exposed to changes with the cash flow of the individual borrower. Default risk for these classifications is best indicated by the general level of employment. Volatility in collateral values follows employment, the nature and availability of financing, general factors of supply and demand and market rates of interest.

The allowance for loan loss consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans. The general component is a formula driven process connected to the Company's risk rating policy and is correlated to historical losses as credits migrate across ratings. The adequacy of the allowance is evaluated by management and is based on historical loss experience adjusted for current factors. The historical loss is traced back by risk rating within each portfolio segment and is based on the actual losses experienced by the Company over the most recent twelve quarters. This actual loss experience is supplemented with other economic and qualitative factors based on the risks present for each portfolio segment. These factors include consideration of the following: levels of and trends in delinquencies, risk classifications and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; other changes in underwriting standards, lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

The Company made no charge-offs in 2017 or 2016. Losses over the most recent twelve quarters have been insignificant relative to the balance of the allowance, a condition prevalent for two consecutive years. Considering the evaluation of the factors above and the sale of $39,664,876 in unguaranteed participations in 2017 and 2016 together, management determined the general component of the allowance supported no additional provision for loan loss in 2017. The Company made a negative provision for loan loss of $1,000,000 in 2016.

The specific component of the allowance for loan loss is established for loans that have been identified as impaired. Measurement of impairment is determined following methods described in Note 1. If impairment is measured by the present value of estimated future cash flows, the Company will establish a specific allocation in the allowance for loan loss for that impairment. Loans that have been restructured because the borrower is experiencing financial difficulties with modified terms and conditions resulting in a concession the Company would not otherwise have made are considered troubled debt restructurings and classified as impaired. Troubled debt restructurings are separately identified for impairment disclosures. For troubled debt restructurings that subsequently default, the Company will reevaluate the amount of specific reserve required for that credit.

(Continued)

NOTE 3 - LOANS (Continued)

When management determines that repayment of an impaired loan is expected solely from liquidation of the collateral, the loan is deemed to be collateral dependent and impairment is measured as the difference between the recorded investment in the loan and the fair value of the collateral, net of costs to sell the collateral. Valuation of the collateral is determined by an independent appraisal. Impairment on collateral dependent loans is charged-off and the loan is written down to net fair value.

(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the periods ending December 31, 2017 and 2016:

December 31, 2017	Residential Construction	Commercial Real Estate	SBA 7(a)	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:							
Beginning balance	$ -	$ 512,481	$ 3,985,177	$ 233	$ 9,461	$ 102	$ 4,507,454
Provision for loan losses	200,253	(317,805)	7,285	63,536	46,833	(102)	-
Loans charged-off	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Total ending allowance balance	$ 200,253	$ 194,676	$ 3,992,462	$ 63,769	$ 56,294	$ -	$ 4,507,454

December 31, 2016	Residential Construction	Commercial Real Estate	SBA 7(a)	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:							
Beginning balance	$ -	$ 227,333	$ 5,220,594	$ 38,608	$ 12,522	$ 8,397	$ 5,507,454
Provision for loan losses	-	285,148	(1,235,417)	(38,375)	(3,061)	(8,295)	(1,000,000)
Loans charged-off	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Total ending allowance balance	$ -	$ 512,481	$ 3,985,177	$ 233	$ 9,461	$ 102	$ 4,507,454

(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2017:

December 31, 2017	Residential Construction	Commercial Real Estate	SBA 7(a)	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ 49,444	$ -	$ -	$ -	$ -	$ 49,444
Collectively evaluated for impairment	200,253	145,232	3,992,462	63,769	56,294	-	4,458,010
Total ending allowance balance	$ 200,253	$ 194,676	$ 3,992,462	$ 63,769	$ 56,294	$ -	$ 4,507,454
Loans:							
Loans individually evaluated for impairment	$ -	$ 197,777	$ 1,592,032	$ 150,153	$ -	$ -	$ 1,939,962
Loans collectively evaluated for impairment	29,661,309	150,024,734	163,404,441	33,570,897	37,456,562	365,350	414,483,293
Total ending loans balance	$ 29,661,309	$ 150,222,511	$ 164,996,473	$ 33,721,050	$ 37,456,562	$ 365,350	$ 416,423,255

(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016:

December 31, 2016	Residential Construction	Commercial Real Estate	SBA 7(a)	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ 3,849	$ -	$ -	$ -	$ -	$ 3,849
Collectively evaluated for impairment	-	508,632	3,985,177	233	9,461	102	4,503,605
Total ending allowance balance	$ -	$ 512,481	$ 3,985,177	$ 233	$ 9,461	$ 102	$ 4,507,454
Loans:							
Loans individually evaluated for impairment	$ -	$ 227,764	$ 1,363,505	$ 166,031	$ -	$ -	$ 1,757,300
Loans collectively evaluated for impairment	-	19,380,388	128,761,860	34,431	2,854,342	583,951	151,614,972
Total ending loans balance	$ -	$ 19,608,152	$ 130,125,365	$ 200,462	$ 2,854,342	$ 583,951	$ 153,372,272

(Continued)

NOTE 3 - LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the period ended December 31, 2017 and 2016:

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential construction	$ -	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-	-
SBA 7(a)	2,082,694	1,592,032	-	1,337,591	-	-
Residential real estate	150,153	150,153	-	158,193	-	-
Commercial	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Subtotal	2,232,847	1,742,185	-	1,495,784	-	-
With an allowance recorded:						
Residential construction	$ -	$ -	$ -	$ -	$ -	$ -
Commercial real estate	644,200	197,777	49,444	211,449	-	-
SBA 7(a)	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Subtotal	644,200	197,777	49,444	211,449	-	-
Totals	$ 2,877,047	$ 1,939,962	$ 49,444	$ 1,707,233	$ -	$ -

December 31, 2016	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential Construction	$ -	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-	-
SBA 7(a)	1,681,613	1,363,505	-	822,826	-	-
Residential real estate	166,031	166,031	-	149,197	-	-
Commercial	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Subtotal	1,847,644	1,529,536	-	972,023	-	-
With an allowance recorded:						
Residential Construction	-	-	-	-	-	-
Commercial real estate	674,186	227,764	3,849	244,925	-	-
SBA 7(a)	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Subtotal	674,186	227,764	3,849	244,925	-	-
Totals	$ 2,521,830	$ 1,757,300	$ 3,849	$ 1,216,948	$ -	$ -

For purposes of this disclosure, the unpaid principal balance is not reduced for net charge-offs.

(Continued)

NOTE 3 - LOANS (Continued)

The Company considers past due loans to be formally in default when the payment due is thirty days delinquent. At sixty days delinquent the Company will typically file a Notice of Default on real estate secured loans and begin legal proceedings to seize collateral on secured commercial and consumer loans.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2017 by class of loans:

December 31, 2017	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Residential construction	$ -	$ -	$ -	$ -	$ 29,661,309	$ 29,661,309
Commercial real estate	-	-	-	-	150,222,511	150,222,511
SBA 7(a)	633,606	-	2,370,123	3,003,729	161,992,744	164,996,473
Residential real estate	-	-	-	-	33,721,050	33,721,050
Commercial	-	-	-	-	37,456,562	37,456,562
Consumer	-	-	-	-	365,350	365,350
Total	$ 633,606	$ -	$ 2,370,123	$ 3,003,729	$ 413,419,526	$ 416,423,255

The following table presents the aging of the recorded investment in past due loans as of December 31, 2016 by class of loans:

December 31, 2016	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Residential construction	$ -	$ -	$ -	$ -	$ -	$ -
Commercial real estate	243,855	-	-	243,855	19,364,297	19,608,152
SBA 7(a)	282,928	-	4,800,424	5,083,352	125,042,013	130,125,365
Residential real estate	-	-	-	-	200,462	200,462
Commercial	-	-	-	-	2,854,342	2,854,342
Consumer	-	-	-	-	583,951	583,951
Total	$ 526,783	$ -	$ 4,800,424	$ 5,327,207	$ 148,045,065	$ 153,372,272

(Continued)

NOTE 3 - LOANS (Continued)

The following tables present the recorded investment in nonaccrual loans as of December 31, 2017 and 2016:

	2017	2016
Residential construction	$ -	$ -
Commercial real estate	215,647	227,764
SBA 7(a)	3,758,751	5,562,448
Residential real estate	170,534	166,031
Commercial	-	-
Consumer	-	-
Total	$ 4,144,932	$ 5,956,243

SBA guaranteed loans in nonaccrual status at December 31, 2017 were $2,359,831. At December 31, 2016 $4,241,522 of SBA guaranteed loans were in nonaccrual status. The Company had no loans past due over 90 days accruing interest as of December 31, 2017 and 2016.

Troubled Debt Restructurings: The Company granted no new troubled debt restructurings in 2017. At December 31, 2017, the Company carried three loans with a total recorded investment of $347,931, classified as troubled debt restructurings. As of December 31, 2016, the Company had three loans with a total recorded investment of $393,795 classified as troubled debt restructurings. The Company made no charge offs of troubled debt restructurings in 2017 and 2016.

The Company has allocated $49,444 and $3,849 of specific reserves to loans classified as troubled debt restructurings as of December 31, 2017 and 2016, respectively. The Company was not committed to lend any additional amounts to customers with outstanding loans that are classified as troubled debt restructurings at either date.

The modification of terms for loans classified as troubled debt restructurings included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The restructured loans in the portfolio as of December 31, 2017 consisted of two residential loans secured by junior liens, one with a recorded investment of $116,571, the other a recorded investment of $33,582, both of which were modified by an extended loan maturity, and one commercial real estate loan with a recorded investment of $197,777, which was modified for both interest rate and maturity. The Company extended the maturity date of this commercial real estate loan in 2017.

The restructured loans in the portfolio as of December 31, 2016 consisted of two residential loans secured by a junior liens, one with a recorded investment of $128,752, the other a recorded investment of $37,279, both which were modified by an extended loan maturity, and one commercial real estate loan with a recorded investment of $227,764, which was modified for both interest rate and maturity.

NOTE 3 - LOANS (Continued)

The Company had no troubled debt restructurings for which there was a payment default within twelve months following the modification in 2017 and 2016. A troubled debt restructuring is considered to be in payment default once it is thirty days contractually past due under the modified terms.

Credit Quality Indicators: The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Pass - Loans that are current in payments and in general compliance with all debt covenants. Management considers the likelihood of loss on these credits to be low.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

(Continued)

NOTE 3 - LOANS (Continued)

The recorded investment of loans by risk category and class of loans as of December 31, 2017 and 2016 follows:

	Pass	Special Mention	Substandard	Doubtful
December 31, 2017				
Residential construction	$ 29,661,309	$ -	$ -	$ -
Commercial real estate	150,024,735	-	197,777	-
SBA 7(a)	154,259,061	-	10,737,412	-
Residential Real estate	33,570,897	-	150,153	-
Commercial	37,367,468	-	89,094	-
Consumer	365,350	-	-	-
Total	$ 405,248,820	$ -	$ 11,174,436	$ -

	Pass	Special Mention	Substandard	Doubtful
December 31, 2016				
Residential construction	$ -	$ -	$ -	$ -
Commercial real estate	19,380,388	-	-	227,764
SBA 7(a)	117,662,437	-	12,462,928	-
Residential Real estate	34,431	-	166,031	-
Commercial	2,854,342	-	-	-
Consumer	583,951	-	-	-
Total	$ 140,515,549	$ -	$ 12,628,959	$ 227,764

(Continued)

NOTE 4 – OTHER REAL ESTATE OWNED (OREO)

Activity in OREO in 2017 and 2016 was as follows:

	2017	2016
Beginning of year	$ -	$ -
Additions through foreclosure	810,387	-
Dispositions	(197,007)	-
End of year	$ 613,380	$ -

	2017	2016
Net gain (loss) on sales	$ 231,882	$ -
Provision for unrealized losses	-	-
Operating expenses, net of rental income	$ -	$ -

NOTE 5 – LOAN SERVICING

Activity for loan servicing rights and the related valuation allowance for the years ended December 31, 2017 and 2016 follows:

	Fair Value Tranche 2017	Impairment Tranche 2017	Total 2017
Loan servicing rights:			
Beginning of year	$ 377,977	$ 6,515,107	$ 6,893,084
Additions	-	2,779,510	2,779,510
Amortization and disposals	-	(1,641,914)	(1,641,914)
Change in impairment		(34,917)	(34,917)
Change in fair value due to changes in assumptions	(130,401)	-	(130,401)
End of year	$ 247,576	$ 7,617,786	$ 7,865,362

(Continued)

NOTE 5 – LOAN SERVICING (Continued)

	Fair Value Tranche 2016	Impairment Tranche 2016	Total 2016
Loan servicing rights:			
Beginning of year	$ 584,549	$ 4,926,895	$ 5,511,444
Additions	-	2,657,540	2,657,540
Amortization and disposals	-	(1,074,833)	(1,074,833)
Change in impairment		5,505	5,505
Change in fair value due to changes in assumptions	(206,572)	-	(206,572)
End of year	$ 377,977	$ 6,515,107	$ 6,893,084

The fair value of all servicing assets was $8,917,781 and $8,265,502 at year end 2017 and 2016. Fair value at year end 2017 was determined using discount rates ranging from 7.0% to 47.2%, and prepayment speeds ranging from 6.5% to 14.1%, depending on the stratification and characteristics of the specific loans. The weighted average discount rate in 2017 was 15.1% and the weighted average prepayment speed was 8.7%. Fair value at year-end 2016 was determined using discount rates ranging from 8.7% to 92.5%, and prepayment speeds ranging from 4.8% to 9.5%, depending on the stratification and characteristics of the specific loans. The weighted average discount rate in 2016 was 15.3% and the weighted average prepayment speed was 7.4%. The Company stratifies servicing assets according to the year the related loan was originated. The Company applies a prepayment factor in fair value calculations derived from published industry statistics for larger loan pools originated in the same year with similar characteristics as the Company's loans. Servicing assets may be subject to impairment if actual prepayment speeds exceed the estimated speed used when the asset was originally recognized. Servicing assets on loans classified as substandard are subject to higher discount and prepayment rates that may result in an impairment allowance. Servicing assets are impaired if the subject loan is nonperforming and the cash flows do not support the servicing spread. The Bank recorded $34,917 of impairment in 2017, and reversed $5,505 of impairment in 2016, related to classified and nonperforming loans in the servicing portfolio.

NOTE 6 - PREMISES AND EQUIPMENT

A summary of premises and equipment as of December 31 are as follows:

	2017	2016
Furniture, fixtures and equipment	$ 1,280,766	$ 918,040
Computer equipment	662,881	570,447
Leasehold improvements	1,340,325	1,132,770
	3,283,972	2,621,257
Accumulated depreciation and amortization	(1,676,733)	(1,830,669)
	$ 1,607,239	$ 790,588

(Continued)

NOTE 6 - PREMISES AND EQUIPMENT (Continued)

Depreciation expense for the years ending December 31, 2017 and 2016 was $279,763 and $235,915, respectively.

Leases for the Company's offices in San Diego, CA, Glendale, CA, Encinitas, CA, San Juan Capistrano, CA and National City, CA hold provisions for specific annual rent increases. The Company is responsible for its proportional share of the increase in common building expenses over a defined base year, which includes maintenance, taxes and insurance.

At December 31, 2017, the future lease rental payable under non-cancellable operating lease commitments was as follows:

	Minimum Lease Payments
2018	$ 981,270
2019	846,724
2020	837,384
2021	785,100
2022	204,195
Thereafter	-
	$ 3,654,674

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense was $754,186 and $626,882 for the years ended December 31, 2017 and 2016, respectively.

NOTE 7 - DEPOSITS

Scheduled maturities of time deposits for the next five years as of December 31, 2017 were as follows:

2018	$ 45,423,744
2019	426,102
2020	2,192,136
2021	196,327
2022	22,828
	$ 48,261,137

Time deposits that meet or exceed the FDIC insurance limit of $250,000 at December 31, 2017 and 2016 were $6,669,396 and $1,507,723, respectively.

(Continued)

NOTE 8 - INCOME TAXES

The details of income tax expense related to the current period and taxes deferred to future periods are presented in the table below:

	2017	2016
Current expense		
Federal	6,299,466	3,965,515
State	1,869,258	819,645
Deferred expense		
Federal	(2,763,756)	(853,877)
State	(1,068,252)	42,207
Remeasurement of net deferred tax asset	3,811,297	-
Total	$ 8,148,013	$ 3,973,490

On December 22, 2017, President Trump signed H.R.1, the Tax Cuts and Jobs Act (the “Act”) into law. Among other things, the Act reduces the corporate federal tax rate from 35% to 21%. The change in the federal tax rate required the Company to remeasure its deferred tax assets and liabilities, resulting in a decrease to the net deferred tax asset, with a corresponding increase to tax expense of $3,811,297. Included in the remeasurement of deferred tax assets and liabilities adjusted through income tax expense was $7,829 for the tax effect on unrealized losses with available for sale securites originally established through other comprehensive income. This results in a disproportionate, or “stranded,” tax effect that is still recorded in accumulated other comprehenisve income. The Company is evaluating the timing of adopting ASU 2018-02 that permits the reclassification of the stranded tax effect into retained earnings.

(Continued)

NOTE 8 - INCOME TAXES (Continued)

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying consolidated balance sheets at December 31:

	2017	2016
Deferred tax assets		
Allowance for loans losses due to tax limitation	$ 943,166	$ 1,054,255
Loans held for sale	9,615,946	10,606,971
Stock-based compensation	168,522	220,326
State taxes	406,665	314,971
Deferred compensation	631,089	615,395
Acquisition accounting fair value adjustments	445,936	-
Organizational expenses	195,302	50,644
Deferred rent	82,834	136,168
Other accrued expenses	355,473	494,024
Unrealized losses on AFS securities and other items	262,330	227,898
	13,107,263	13,720,652
Deferred tax liabilities		
Servicing assets and fair value option	(2,051,510)	(2,735,323)
Deferred loan origination costs	(1,745,518)	(1,612,857)
Core deposit intangible	(707,594)	-
Depreciation	(64,081)	(141,710)
Unrealized gains on AFS securities and other items	(32,141)	(36,611)
Net deferred tax assets	$ 8,506,419	$ 9,194,151

At December 31, 2017 Management reevaluated the Company's projected future taxable income amounts and concluded that there were sufficient future projected earnings to absorb the deferred tax assets. Accordingly, the Bank determined that a valuation allowance was not warranted.

The Company has no significant unrecognized tax benefits as of December 31, 2017 or 2016, and the Company does not expect any significant increase in unrecognized tax benefits in the next twelve months. Additionally, the Company had no material interest and penalties paid or accrued related to income taxes reported in the income statement for the years ended December 31, 2017, and 2016.

NOTE 8 - INCOME TAXES (Continued)

The Company's annual effective tax rate of 78.1% and 36.5% for 2017 and 2016, respectively, differed from the federal statutory rate of 35% in 2017 and 2016, due to the items presented in the table below:

	2017	2016
Computed federal income tax expense	3,652,773	3,808,922
State income tax, net of federal income tax benefit	520,654	560,204
Stock-based compensation	(422,173)	(207,804)
Cash surrender value of officer life insurance	(126,071)	(108,698)
Net deferred tax asset remeasurement	3,811,297	(189,372)
Merger and other nondeductible expense	599,122	102,841
Other differences	112,411	7,397
Income tax expense	8,148,013	3,973,490

Upon exercise or vesting of a share based award, if the tax deduction exceeds the compensation cost that was previously recorded for financial statement purposes this will result in an excess tax benefit. ASU 2016-09 *"Compensation-Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting"* requires the Company to recognize all excess tax benefits or tax deficiencies through the income statement as income tax expense/benefit. Under previous GAAP, any excess tax benefits were recognized in additional paid-in capital to offset current-period and subsequent-period tax deficiencies. The Company chose to early adopt ASU 2016-09 in 2016 using the modified retrospective transition method. A tax benefit of $546,563 and $292,331 was recorded in 2017 and 2016 respectively, as a result of share awards vesting and exercised during the year.

The Company is subject to Federal income tax and income tax of various state jurisdictions. Federal income tax returns for the years ended December 31, 2017, 2016, 2015, and 2014, are open to audit by the Federal authorities and state tax returns for the years ended December 31, 2017, 2016, 2015, 2014, and 2013 are open to audit by state authorities.

NOTE 9 – OTHER EXPENSES

Other expenses as of December 31 of each respective year are presented below.

	2017	2016
Data processing	$ 1,800,369	$ 881,845
Advertising and business development	625,425	511,176
Professional fees	2,375,764	763,328
Regulatory assessments	429,655	339,245
Shareholder administration expense	412,096	296,743
Deposit administration expense	4,132,126	3,412,171
Loan administration expense	2,205,071	1,792,386
Office operation expense	340,624	302,927
Core deposit intangible amortization	107,715	-
Other operating expenses	1,129,633	906,138
	$ 13,558,478	$ 9,205,959

(Continued)

NOTE 10 - BORROWING ARRANGEMENTS

The Company has a credit facility with a third party correspondent bank that began in 2015. The debt is secured by all of the Company's common stock in the subsidiary Bank. The Company made take-downs under the facility of $7,000,000 in 2017 and $4,000,000 in 2016. Terms of the facility were renegotiated in September 2017. The monthly adjustable rate was modified from the one month LIBOR plus 4.00% to one month LIBOR plus 3.50% and the maturity date was extended from March 2020 to March 2025. The stated rate as of December 31, 2017 was 4.86%. The balance outstanding at December 31, 2017 and 2016 was $14,668,859 and $9,299,092, respectively. Principal and interest payments are due quarterly. The loan fully amortizes over the remaining term. The Company and Bank must maintain certain capital and other performance standards under the covenants of the loan. As of December 31, 2017 and 2016, management believes the Company and Bank are in compliance with all the required standards and covenants. Scheduled principle amortization by year through the maturity date is presented below:

2018	1,571,749
2019	2,095,720
2020	2,095,720
2021	2,095,720
2022	2,095,720
2023	2,095,720
2024	2,095,720
2025	522,790
	14,668,859

The Bank has a total of $30.5 million in overnight purchased funds lines through three correspondent banks. Credit extended through these lines is unsecured. As of December 31, 2017 and 2016, no amounts were outstanding under these arrangements.

As of December 31, 2017, the Bank's borrowing capacity with the FHLB of San Francisco (FHLBSF) was $120,509,119. The principal balance of real estate secured loans pledged against the line was $160,006,265 and the principal balance of commercial loans pledged was $51,234,892. The Bank had $85,000,000 of advances outstanding at December 31, 2017, consisting of one advance for $65,000,000 bearing interest at 1.49% and maturing January 4, 2018 and one advance for $20,000,000 bearing interest at 1.45% and maturing January 4, 2018.

As of December 31, 2016, the Bank's credit facility available with the FHLBSF was $144,698,750. The principal balance of real estate secured loans pledged against the line was $10,983,927 and the principal balance of commercial loans pledged was $2,606,000. The Bank had no advances outstanding at December 31, 2016.

The Bank also has borrowing capacity at the discount window with the Federal Reserve Bank of San Francisco. At December 31, 2017, the Bank had $1,958,231 available on this line secured by pledged real estate secured loans with a principal balance of $5,288,045. At December 31, 2016, the Bank had $2,442,698 available on this line secured by pledged real estate secured loans with a principal balance of $7,103,777. The Bank had no borrowed money outstanding through the discount window at December 31, 2017 and 2016.

(Continued)

NOTE 11 – EMPLOYEE BENEFITS

The Bank offers a 401(k) benefit plan that allows employees to contribute from their compensation. These contributions are matched equal to 50% of the first 6% of the compensation contributed. The Bank's matching expense for 2017 and 2016 was $274,285 and $264,768, respectively.

The Company provides an incentive for the staff to participate in the ownership of the Company through the Seacoast Commerce Banc Holdings Employee Stock Purchase Plan ("ESPP"). Under the terms of the ESPP, employees are allowed to contribute a portion of their salary to the ESPP each pay period, subject to a specific aggregate limit per year. The contributions are then used to purchase common stock of the Company that vest to the employee immediately when they are purchased. The Company will match 15% of the employees' contributions to the ESPP. The ESPP purchases shares of the Company's stock each pay period based on the current stock price at the date of purchase. There are no "look-back" or other option-like features in the plan. The Company's expense related to the ESPP is limited to its 15% matching contributions, and was $37,764 and $73,028 for the years ended December 31, 2017 and 2016.

In 2017 the Company created a deferred compensation plan for sales personnel that meet certain defined annual objectives. Awards vest in equal annual increments over a five year service period with the vested increment paid-out at the vesting date. Interest accrues on the deferred balance at 5% per year. The Company recorded $65,749 in compensation expense for this program in 2017 and the vested liability payable at December 31, 2017 was an equal amount.

In 2014 the Bank created a Salary Continuation Plan for the benefit of certain executive officers. The Plan provides each executive with a fixed annual annuity payment for a specified term after retirement provided the executive's service with the Bank continues uninterrupted until the defined retirement age of 65. Benefits vest to the officers in determined increments over the service period. The Bank accrues the future benefits payable following FASB ASC 715 *Compensation – Retirement Benefits* using acceptable actuarial techniques with appropriate discount rates. Expense recorded in 2017 and 2016 for the Salary Continuation Plan was $605,640 and $554,684, respectively. The liability recorded for future benefits was $2,136,721 at December 31, 2017 and $1,531,081 as of December 31, 2016.

NOTE 12 - RELATED-PARTY TRANSACTIONS

In the ordinary course of business, the Company may grant loans to certain officers and directors and the companies with which they are associated. The balance of these loans outstanding at December 31, 2017 and 2016 was $0 and $460,113, respectively.

Deposits from certain directors and their related interests with which they are associated, held by the Company amounted to approximately $641,830 and $1,465,670 at December 31, 2017 and 2016, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company enters into financial commitments to meet the financing needs of its customers. These financial commitments include undisbursed commitments under term loans and unused revolving lines of credit. Those commitments involve, to varying degrees, elements of credit and interest rate risk not reflected in the Company's financial statements. The loss reserve for these unfunded commitments is evaluated following the same principles and methods used for the allowance for loan loss. The balance of the reserve for unfunded commitments at December 31, 2017 was $98,620. At December 31, 2016 the reserve balance was $38,620. The Company's exposure to loan loss in the event of nonperformance on unfunded commitments is represented by the contractual

(Continued)

NOTE 13 - COMMITMENTS AND CONTINGENCIES (Continued)

amount of those commitments. Credit policy and practice for unfunded commitments and fully disbursed loans is identical and integrally related.

As of December 31, 2017 and 2016, the Company had the following outstanding financial commitments whose contractual amount represents credit risk:

	2017	2016
Undisbursed commitments under term loans and revolving lines of credit	$ 97,549,516	$ 38,620,403
Financial standby letters of credit	150,885	-
	$ 97,700,401	$ 38,620,403

NOTE 14 - STOCK-BASED COMPENSATION

With the creation of Seacoast Commerce Banc Holdings effective November 30, 2014, all previous Bank equity incentive plans were merged with and into the SCBH 2014 Omnibus Equity Incentive Plan (the “2014 Plan”). All outstanding awards and grants under the previous plans were assumed without change to existing terms and conditions, and converted to an equivalent award or grant of options for Company common stock.

In 2017, the Company shareholders approved an increase in the number of shares available for grant under the Plan to 2,000,000. The terms of the 2014 Plan state that officers and key employees may be granted restricted stock, nonqualified options and incentive stock options. Directors and other consultants, who are not also an officer or employee, may not be granted incentive stock options. Options may be granted at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant. The 2014 Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company policy is to issue new shares for the exercise of stock options and vesting of restricted stock awards. The amount of authorized and unissued shares available is sufficient to satisfy all expected option exercises and vesting restricted stock awards.

The Company recognized stock-based compensation costs of $947,925 and $859,524 in 2017 and 2016, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions presented below:

	2017	2016
Expected volatility	26.85%	30.62%
Expected term	6.5 yrs	6.5 yrs
Risk free rate	2.12%	1.73%
Dividend rate	1.60%	0.16%
Weighted-average grant date fair value	$ 5.06	$ 5.33

(Continued)

NOTE 14 - STOCK-BASED COMPENSATION (Continued)

Since the Company's stock is thinly traded over the counter with limited transaction volumes, the expected volatility is based on the historical volatility of similar holding companies and banks that have greater trading volumes and longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Company does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for U.S. Treasury bonds with the same expected term as the options. The average dividend rate is calculated using the implied annual dividend and fair value of the common stock on the date a grant is made. In May 2016 the Company declared its first cash dividend on common shares. At the same time, the 2014 Plan was modified to make the unvested restricted stock awards eligible to receive the dividend, making those grants securities participating in the earnings of the Company.

A summary of the status of the Company's stock option plan as of December 31, 2017, and changes during the year ending thereon is presented below:

	2017			
	Options	Weighted Average Exercise Price	Weighted Average Remaining Years	Aggregate Intrinsic Value
Balance, beginning of year	801,985	$ 6.83		
Granted	90,500	20.04		
Exercised	(92,391)	5.19		
Forfeited or expired	(10,600)	15.16		
Balance, end of year	789,494	$ 8.43	4.7	$9,375,046
Fully vested and expected to vest	789,494	$ 8.43	4.7	$9,375,046
Options exercisable at end of year	584,775	$ 5.74	3.5	$8,512,810

As of December 31, 2017 there was $771,715 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 2.2 years.

(Continued)

NOTE 14 - STOCK-BASED COMPENSATION (Continued)

Grants of restricted stock awards vest over five years. The table below details the 2017 activity in restricted stock awards made under the 2014 Plan.

	2017	Weighted Average Fair Value
Balance, beginning of year	207,322	$ 12.22
Granted	41,592	18.08
Vested	(74,798)	8.07
Forfeited	(800)	15.79
Balance, end of year	173,316	$ 12.73

The restricted stock awards granted in 2017 had a combined fair value of $752,004. The restricted stock awards vested in 2017 had an intrinsic value of $1,522,139 and the related tax benefit was $279,920. At December 31, 2017 the Company had total unrecognized compensation cost related to the outstanding restricted stock awards of $1,599,048 to be recognized over a weighted-average period of 2.0 years.

NOTE 15 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

NOTE 15 - FAIR VALUE (Continued)

Investment Securities: The fair value of investment securities are calculated based on market prices of similar securities (Level 2).

Impaired Loans: The fair value of impaired loans is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

SBA Unguaranteed Loans: Unguaranteed portions retained from guaranteed loan sales made before 2011 are subject to an irrevocable election of the fair value accounting option. These unguaranteed loans are accounted for at fair value on a recurring basis with the changes in fair value for the period recorded in earnings. The retained portion is measured at fair value through discounted cash flows with certain default and loss rate assumptions using discount rates higher than the stated note rate (Level 3). The higher discount rate is warranted as the credit risk associated with the unguaranteed portion is higher than the guaranteed portion sold.

SBA Loan Servicing Assets: Upon sale of the guaranteed loans to third parties, the servicing right asset is recognized at fair value with the income statement effect recorded in gain on sales of loans. Servicing assets in the Impairment Tranche (see Note 5) are recorded at fair value on a non-recurring basis thereafter.

The servicing assets in the Fair Value Tranche are recorded at fair value on a recurring basis. On a quarterly basis, these loan servicing assets are measured and recorded at fair value with the resulting change in fair value recorded in earnings.

Fair value for both the Impairment Tranche and Fair Value Tranche is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model uses a variety of assumption inputs that include available market data and proprietary data that is not readily available to market participants (Level 3).

NOTE 15 - FAIR VALUE (Continued)

Assets measured at fair value on a recurring basis at December 31 are summarized below.

		Fair Value Measurements at		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Mortgage-backed securities, residential	$ 5,985,109	$ -	$ 5,985,109	$ -
Corporate	$ 504,365	$ -	$ 504,365	$ -
Total available for sale securities	$ 6,489,474	$ -	$ 6,489,474	$ -
SBA unguaranteed loans	$ 1,606,478	$ -	$ -	$ 1,606,478
SBA loan servicing assets	$ 247,576	$ -	$ -	$ 247,576

		Fair Value Measurements at		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
Mortgage-backed securities, residential	$ 3,307,891	$ -	$ 3,307,891	$ -
Total available for sale securities	$ 3,307,891	$ -	$ 3,307,891	$ -
SBA unguaranteed loans	$ 2,231,727	$ -	$ -	$ 2,231,727
SBA loan servicing assets	$ 377,977	$ -	$ -	$ 377,977

(Continued)

NOTE 15 - FAIR VALUE (Continued)

There were no transfers in or out of Level 1 or Level 2 during 2017 or 2016.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended December 31, 2017:

	SBA Unguaranteed Loans	SBA Servicing Assets
Balance of recurring Level 3 assets at January 1	$ 2,231,727	$ 377,977
Total changes in fair value		
Included in earnings - realized	24,053	(115,016)
Included in earnings - unrealized	(13,127)	(15,385)
Total additions	-	-
Total disposals	(636,175)	-
Transfers out of Level 3	-	-
Balance of recurring Level 3 assets at December 31	$ 1,606,478	$ 247,576

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended December 31, 2016:

	SBA Unguaranteed Loans	SBA Servicing Assets
Balance of recurring Level 3 assets at January 1	$ 3,739,491	$ 584,549
Total changes in fair value		
Included in earnings - realized	54,390	(184,163)
Included in earnings - unrealized	(6,595)	(22,409)
Total additions	-	-
Total disposals	(1,555,559)	-
Transfers out of Level 3	-	-
Balance of recurring Level 3 assets at December 31	$ 2,231,727	$ 377,977

(Continued)

NOTE 15 - FAIR VALUE (Continued)

The following table presents quantitative information about recurring Level 3 fair value measurements at December 31, 2017:

Recurring level 3 Fair Value Inputs 2017	Fair value	Valuation Technique	Unobservable Inputs	Range of Inputs
SBA unguaranteed loans	$1,606,478	Discounted Cash Flow	Constant Prepayment Rate	7.1% to 8.5%
			Default Rate	11.7% to 29.3%
			Loss on Default	6.7% to 16.4%
			Discount Rate	7.8% to 14.3%
SBA loan servicing assets	$ 247,576	Discounted Cash Flow	Constant Prepayment Rate	6.5% to 8.2%
			Discount Rate	13.1% to 45.5%

The following table presents quantitative information about recurring Level 3 fair value measurements at December 31, 2016:

Recurring level 3 Fair Value Inputs 2016	Fair value	Valuation Technique	Unobservable Inputs	Range of Inputs
SBA unguaranteed loans	$2,231,727	Discounted Cash Flow	Constant Prepayment Rate	5.1% to 7.4%
			Default Rate	12.2% to 28.6%
			Loss on Default	7.3% to 17.1%
			Discount Rate	7.6% to 13.7%
SBA loan servicing assets	$ 377,977	Discounted Cash Flow	Constant Prepayment Rate	4.7% to 7.3%
			Discount Rate	12.0% to 92.5%

NOTE 15 - FAIR VALUE (Continued)

At December 31, 2017, SBA unguaranteed loans held for investment subject to a fair value option had an aggregate fair value of $1,606,478 and an aggregate outstanding principal balance of $1,683,244. At December 31, 2016, SBA unguaranteed loans held for investment subject to a fair value option had an aggregate fair value of $2,231,727 and an aggregate outstanding principal balance of $2,319,420. At December 31, 2017 and 2016, none of the SBA unguaranteed loans subject to a fair value option were in nonaccrual status.

SBA unguaranteed loans measured at fair value on a recurring basis are valued using discounted cash flow methods that apply prepayment factors and default rates compiled from industry statistics available for large aggregate loan pools by year of origination. This data is then modified by unobservable proprietary information to develop assumptions for prepayments, default losses and recoveries specific to the characteristics of individual loans based on seasoning, industry classification and geographic location. Discount rates are built from the implied discounts inherent in the gain on sale accounting treatment for the unguaranteed loan retained. Fair value will decrease as assumptions for prepayment speeds, default losses and discount rates increase. Fair value will increase as assumptions for these inputs decrease.

Servicing rights for SBA guaranteed loans measured at fair value on a recurring basis are valued using discounted cash flow methods. Prepayment factors are modified from general industry statistics for the specific characteristics of seasoning, industry classification and geographic location of the underlying loan following the same practice applied for the unguaranteed loans. Default losses are not applicable to servicing assets associated with SBA guaranteed loans. The Company applies a proprietary method of building discount rates for servicing asset cash flow that implies a return comparable to that received on the cash flows sold, resulting in discount rates commensurate with premium prices in the secondary market. Fair value will decrease as assumptions for prepayment speeds and discount rates increase. Fair value will increase as assumptions for these inputs decrease.

The Company's recurring Level 3 fair value measurements above are supported by an independent consultant. The Company provides the consultant with an extensive database of loan specific information including date of origination, index rate and margin, servicing spread, payment history; original loan to value, current risk classification, current debt service coverage, industry classification and geographic location. Valuations and changes therewith are reviewed by a committee of the Board of Directors and reconciled to aggregate industry statistics and the Company's internal records for margin pricing, actual sales consummated, loan payoffs, delinquency, defaults and charge offs.

(Continued)

NOTE 15 - FAIR VALUE (Continued)

The Company had no assets stated at fair value on a non-recurring basis as of December 31, 2017 and 2016. There were no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2017 or 2016.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2017 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2017 Using Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 5,532,096	$ 5,532,096			$ 5,532,096
Interest-bearing deposits in other banks	71,755,308	71,755,308			71,755,308
Investments available-for-sale	6,489,474		6,489,474		6,489,474
Federal Reserve Bank and other restricted stock	6,869,706				NA
Loans, net	411,915,801			410,928,782	410,928,782
Loans held for sale	359,435,619		389,503,583		389,503,583
Accrued interest receivable	3,229,553		1,663,644	1,565,909	3,229,553
Financial liabilities:					
Deposits	720,853,808	295,694,232	427,695,000		723,389,232
FHLB advances	85,000,000		85,000,000		85,000,000
Other borrowed money	14,668,859		14,668,859		14,668,859
Accrued interest payable	49,035		49,035		49,035

	Notional Amount	Cost to Assume
Off-balance sheet instruments:		
Unused commitments under term loans and revolving lines of credit	97,549,516	975,495
Performance standby letters of credit	$ 150,885	$ 1,509

(Continued)

NOTE 15 - FAIR VALUE (Continued)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2016 are as follows:

		December 31, 2016 Using			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 2,861,294	$ 2,861,294			$ 2,861,294
Interest-bearing deposits in other banks	84,094,335	84,094,335			84,094,335
Investments available-for-sale	3,307,891		3,307,891		3,307,891
Federal Reserve Bank and other restricted stock	4,200,306				NA
Loans, net	148,864,818			149,213,447	149,213,447
Loans held for sale	292,950,330		316,436,030		316,436,030
Accrued interest receivable	1,785,871		1,168,535	617,336	1,785,871
Financial liabilities:					
Deposits	510,162,741	261,618,752	249,731,000		511,349,752
Other borrowed money	9,299,092		9,299,092		9,299,092
Accrued interest payable	25,054		25,054		25,054

	Notional Amount	Cost to Assume
Off-balance sheet instruments:		
Unused commitments under term loans and revolving lines of credit	$ 38,620,403	$ 386,204

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and Due from Other Banks: The carrying amounts of cash and due from banks approximate their fair value (Level 1).

Interest-Bearing Deposits in Banks: The carrying amount of interest-bearing deposits in other banks approximate their fair value because of the short term maturities of these deposits (Level 1).

Loans: The fair value of SBA loans held for sale is derived from recent sales transactions for similar loans (Level 2). For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality (Level 3). See previous descriptions regarding the fair value measurement bases for SBA unguaranteed loans, impaired loans and SBA loan servicing assets. The methods used to estimate the fair value of loans do not necessarily represent an exit price.

Accrued Interest Receivable: The carrying amounts of accrued interest approximate their fair value, and are classified within the same level of the fair value hierarchy as the related asset.

(Continued)

NOTE 15 - FAIR VALUE (Continued)

Federal Reserve Bank and other restricted stock: It is not practical to estimate the fair value of FRB and other restricted stock due to restrictions placed on its transferability.

Deposits: The fair value of demand deposits is the amounts payable on demand (Level 1). The fair value of savings deposits, money market accounts and time deposits was based on the discounted value of expected cash flows. An industry average was used for the expected duration of deposits without contractual maturity dates. The discount rate was estimated utilizing the industry average rates currently offered for deposits with similar remaining maturities (Level 2).

FHLB advances: The carrying amount approximates fair value due to the short maturities on January 4, 2018.

Other Borrowed Money: The carrying amount approximates fair value due to the monthly interest rate adjustment and the margin typically found in the industry for loans of similar term, structure and collateral (Level 2).

Accrued Interest Payable: The carrying amounts of accrued interest approximate their fair value.

Commitment to fund Loans: The fair value of commitments to fund loans represents fees currently charged to enter into similar agreements with similar remaining maturities.

Performance standby letters of credit: The fair value of these letters of credit represents fees currently charged to enter into similar agreements with similar terms and maturities.

NOTE 16 - REGULATORY MATTERS

The Company and Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

The final rules implementing the Basel Committee on Banking Supervision’s capital guidelines for U. S. Banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% in 2015 to 2.50% in 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Management believes, as of December 31, 2017, that the Company and Bank meet all capital adequacy requirements. As of December 31, 2017 and 2016, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands) as of December 31:

(Continued)

NOTE 16 - REGULATORY MATTERS (Continued)

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2017						
Total Capital to risk weighted assets						
Company	$ 76,200	13.60%	$ 44,812	8.0%	N/A	N/A
Bank	89,270	15.95%	44,788	8.0%	55,985	10.0%
Tier 1 (Core) Capital to risk weighted assets						
Company	71,594	12.78%	33,609	6.0%	N/A	N/A
Bank	84,664	15.12%	33,591	6.0%	44,788	8.0%
CET1 (Core) Capital to risk weighted assets						
Company	71,594	12.78%	25,207	4.5%	N/A	N/A
Bank	84,664	15.12%	25,193	4.5%	36,390	6.5%
Tier 1 (Core) Capital average assets						
Company	71,594	7.96%	35,978	4.0%	N/A	N/A
Bank	$ 84,664	9.42%	$ 35,953	4.0%	$ 44,941	5.0%

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2016						
Total Capital to risk weighted assets						
Company	$ 43,786	16.53%	$ 21,196	8.0%	N/A	N/A
Bank	53,326	20.07%	21,254	8.0%	26,568	10.0%
Tier 1 (Core) Capital to risk weighted assets						
Company	40,445	15.27%	15,897	6.0%	N/A	N/A
Bank	49,986	18.81%	15,941	6.0%	21,254	8.0%
CET1 (Core) Capital to risk weighted assets						
Company	40,445	15.27%	11,922	4.5%	N/A	N/A
Bank	49,986	18.81%	11,955	4.5%	17,269	6.5%
Tier 1 (Core) Capital average assets						
Company	40,445	6.99%	23,132	4.0%	N/A	N/A
Bank	$ 49,986	8.63%	$ 23,161	4.0%	$ 28,951	5.0%

(Continued)

NOTE 16 - REGULATORY MATTERS (Continued)

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the greater of the bank's undivided profits, net income for the previous fiscal year, or net income for the current year, without the prior approval of the commissioner. Prior approval of the Federal Reserve is required if dividends in any one calendar year exceed the total of net income for that year plus the net income of the previous two years, less dividends paid in the previous two years. Dividends from the Bank to the Company must meet these restrictions.

NOTE 17 – EARNINGS PER SHARE

Basic and diluted earnings per common share are presented for the respective years then ended in the tables below.

	2017	2016
Basic		
Net Income	$2,288,481	$6,909,144
Less: Dividends and discount accretion on preferred stock	-	(16,580)
Net Income available to common shareholders	2,288,481	6,892,564
Weighted average:		
Common shares outstanding	6,741,166	5,841,146
Participating securities	180,470	129,380
Average shares	6,921,636	5,970,526
Basic earnings per common share	$ 0.33	$ 1.15
Diluted		
Net Income allocated to common shareholders	2,288,481	6,892,564
Weighted average shares outstanding for basic earnings per share	6,921,636	5,970,526
Add: Dilutive effects of assumed exercises of stock options	441,755	422,626
Average shares and dilutive potential common shares	7,363,391	6,393,152
Diluted earnings per common share	$ 0.31	$ 1.08

The SCBH 2014 Omnibus Equity Incentive Plan was modified in May 2016 to make the unvested restricted stock awards eligible to receive dividends declared on common shares. The unvested restricted stock awards became participating securities as of the date the Plan was changed.

NOTE 17 – EARNINGS PER SHARE (Continued**)**

Stock options for 175,257 and 118,557 shares of common stock were not considered in computing diluted earnings per common share for 2017 and 2016, respectively, because they were antidilutive.

NOTE 18 - SENIOR PREFERRED STOCK

Seacoast Commerce Banc Holdings issued 4,000 shares of Senior Non-cumulative Perpetual Preferred Stock, Series A to the United States Department of the Treasury (the "Treasury"), under the Small Business Lending Fund Program, effective with the closing of the reorganization transaction on November 30, 2014. The Series A preferred stock paid non-cumulative dividends quarterly at 1% per annum, a rate that continued until March 1, 2016 when the dividend rate increased to a fixed 9%. The Series A preferred shares had a par value of $1,000 making the aggregate par value $4,000,000. The carrying value of the Preferred Stock was accreted up to par value against retained earnings through the period ending March 1, 2016, reducing the reported income available for common shareholders. On March 10, 2016 the Company redeemed the preferred stock from the Treasury at par value plus accrued dividends of $15,667, retiring the shares.

NOTE 19 – BUSINESS COMBINATION

On October 1, 2017 the Company acquired all of the outstanding common shares of Capital Bank, headquartered in San Juan Capistrano, CA, for $55,520,267 in SCBH common shares and $16,205,704 in cash, for total purchase consideration of $71,725,971. The Agreement and Plan of Reorganization and Merger (Agreement) between the parties provided for the exchange of SCBH common shares and cash for Capital Bank common shares, subject to certain defined allocation and proration procedures resulting in aggregate purchase consideration paid by SCBH of 80% common shares and 20% cash. In general, Capital Bank shareholders received 1.73 shares of SCBH common stock and $6.40 in cash for every share of Capital Bank exchanged. The fair value of shares issued by SCBH was determined by the market closing price of those shares on the last trading date before October 1, 2017. Capital Bank results of operations are included in the Company's 2017 Consolidated Statement of Income beginning with the closing date of the transaction. Acquisition related costs of $2,459,018 are included in other expenses for the period.

(Continued)

NOTE 19 – BUSINESS COMBINATION (Continued)

The merger provides the Company with scale and cost efficiencies to compete with larger institutions in the service area. These efficiencies support the recognition of $35,393,645 in Goodwill that will not be deductible for income tax purposes. The following table summarizes the consideration paid for Capital Bank and the amounts of assets acquired and assumed liabilities recognized at the acquisition date:

CONSIDERATION PAID	
Cash	$ 16,205,704
SCBH common shares	55,520,267
Fair value of consideration paid	$ 71,725,971
ASSETS ACQUIRED	
Cash and due from banks	27,657,928
Gross Loans held for investment	255,605,193
SBA loan servicing assets	1,114,604
Deferred tax asset (liability)	(741,181)
Core deposit intangible	2,536,699
Accrued interest and other assets	6,899,191
Total assets acquired	293,072,434
LIABILITIES ASSUMED	
Deposits	241,471,814
FHLB advance	15,000,000
Accrued interest and other liabilities	268,295
Toal liabilities assumed	256,740,109
Excess of assets acquired over liabilities assumed	36,332,325
Goodwill recognized	35,393,645
	71,725,971

Assets acquired and liabilities assumed have been recorded at fair value following the guidance for acquisition accounting, generally determined by discounted cash flows methods. The Company believes that none of the loans acquired show evidence of credit deterioration to the extent of impairment, and expects to collect all of the contractual cash flows related to loans and accrued interest receivable. The gross contractual cash flows receivable for these acquired assets were $310,024,612 at the acquisition date.

NOTE 20 – PARENT COMPANY FINANCIAL INFORMATION

Unconsolidated financial information for the parent company only, Seacoast Commerce Banc Holdings (Note 1), as of December 31, 2017 and 2016 is presented below.

SEACOAST COMMERCE BANC HOLDINGS
Condensed Balance Sheets
As of December 31, 2017 and 2016

	2017	2016
ASSETS		
Cash and due from banks	$ 1,964,465	$ 463,539
Deferred tax asset	54,299	50,644
Accrued interest and other assets	28,119	107,781
Investment in subsidiary	121,588,878	50,304,296
Total assets	$ 123,635,761	$50,926,260
LIABILITIES AND SHAREHOLDERS' EQUITY		
Other borrowed money	14,668,859	9,299,092
Accrued interest and other liabilities	448,939	48,038
Total liabilities	15,117,798	9,347,130
Total shareholders' equity	108,517,963	41,579,130
Total liabilities and shareholders' equity	$ 123,635,761	$50,926,260

SEACOAST COMMERCE BANC HOLDINGS
Condensed Statements of Income and Comprehensive Income
For the years ended December 31

	2017	2016
Dividends from subsidiary	$ 4,050,000	$ 1,800,000
Interest expense	(543,221)	(440,187)
Noninterest income	-	-
Noninterest expense	(242,119)	(160,561)
Equity in undistributed earnings of subsidairy	(1,284,782)	5,437,835
Earnings before income tax	1,979,878	6,637,087
Income tax benefit	308,603	272,057
Net Income	$ 2,288,481	$ 6,909,144
Comprehensive income	$ 2,243,920	$ 6,902,481

(Continued)

NOTE 20 – PARENT COMPANY FINANCIAL INFORMATION (Continued)

SEACOAST COMMERCE BANC HOLDINGS
Condensed Statements of Cash Flows
For the years ended December 31

	2017	2016
Cash flows from operating activities		
Net income	$ 2,288,481	$ 6,909,144
Adjustments to reconcile net income to net cash used in operating activities		
Amortization of financing costs	9,168	10,284
Equity in undistributed (earnings) loss of subsidiary	1,284,782	(5,437,835)
Net change in deferred tax asset	(3,655)	3,820
Net change in accrued interest and other assets	70,493	(51,165)
Net change in accrued interest and other liabilities	400,901	7,119
Net cash from operating activities	4,050,170	1,441,367
Cash flows from investing activities		
Capital contribution to subsidiary	(71,666,001)	-
Net cash flows from investing activities	(71,666,001)	-
Cash flows from financing activities		
Proceeds from other borrowed money	7,000,000	4,000,000
Repayment of other borrowed money	(1,630,233)	(1,162,386)
Redemption of preferred stock	-	(4,000,000)
Proceeds from issuance of common stock	65,963,383	349,500
Dividends declared on preferred stock	-	(15,667)
Dividends declared on common stock	(2,216,396)	(910,776)
Net cash flows from financing activities	69,116,754	(1,739,329)
Net (decrease) increase in cash and cash equivalents	1,500,923	(297,962)
Beginning cash and cash equivalents	463,539	761,501
Ending cash and cash equivalents	$ 1,964,462	$ 463,539

NOTES

NOTES

May 16, 2018, 4:00 P.M.
Country Club of Rancho Bernardo
12280 Greens East Road, San Diego, CA 92128

INVESTOR RELATIONS
Richard M. Sanborn
President and Chief Executive Officer
11939 Rancho Bernardo Road, Suite 200
San Diego, CA 92128
(858) 432-7001
rsanborn@scbholdings.com

LISTING OF COMMON STOCK
Common Stock: SCBH

EXECUTIVE MANAGEMENT
Richard M. Sanborn
President
Chief Executive Officer

David H. Bartram
Senior Executive Vice President
Chief Operating Officer

William T. Roche III
Senior Executive Vice President
Chief Financial Officer

Richard Visser
Senior Executive Vice President
Chief Credit Officer

CERTIFIED PUBLIC ACCOUNTANTS
Crowe Horwath, LLP
650 Town Centre Drive, Suite 740
Costa Mesa, CA 92626

Seacoast Commerce Banc Holdings®

BOARD OF DIRECTORS

Allan W. Arendsee
Chairman of the Board

David H. Bartram
Director, Senior Executive Vice President
Chief Operating Officer

Lisa M. Betyar
Director

Robert D. DePhilippis
Director

Dr. Irving "Bud" Feldkamp, III
Director

B. Ted Field M.D.
Director

Richard S. Levenson
Director

Timothy K. O'Connor
Director

Richard M. Sanborn
Director, President
Chief Executive Officer

TRANSFER AGENT, AND REGISTER OF COMMON STOCK
Computershare
211 Quality Circle, Suite 210
College Station, TX 77845
(800) 843-5542

CALIFORNIA

ENCINITAS
LOS ANGELES
NATIONAL CITY
ORANGE COUNTY
SACRAMENTO
SAN DIEGO
SAN JUAN CAPISTRANO
SAN FRANCISCO

ARIZONA

PHOENIX

COLORADO

DENVER

MASSACHUSETTS

BOSTON

MISSOURI

ST. LOUIS

NEVADA

LAS VEGAS
RENO

OREGON

EUGENE

TEXAS

AUSTIN
DALLAS / FT. WORTH
HOUSTON

UTAH

SALT LAKE CITY

WASHINGTON

SEATTLE

Phone: 858.432.7000
Web: www.scbholdings.com